COMPLETED
Y 4.EN 2:S.hrg.99-417
869

S. HRG. 99-417

AMENDING THE MINERAL LANDS LEASING ACT OF 1920, AND OTHER COAL RELATED ISSUES

124

HEARING

ORIGINAL

BEFORE THE

SUBCOMMITTEE ON
NATURAL RESOURCES DEVELOPMENT AND PRODUCTION

OF THE

COMMITTEE ON
ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

ON

S. 372

A BILL TO AMEND THE MINERAL LANDS LEASING ACT OF 1920, AND FOR OTHER PURPOSES

S. 570

A BILL TO AMEND THE MINERAL LANDS LEASING ACT OF 1920 TO IMPROVE THE ADMINISTRATION OF THE FEDERAL COAL LEASING PROGRAM, AND FOR OTHER PURPOSES

S. 913

A BILL TO AMEND THE MINERAL LANDS LEASING ACT OF 1920 TO IMPROVE THE ADMINISTRATION OF THE FEDERAL COAL LEASING PROGRAM, AND FOR OTHER PURPOSES

S. 946

A BILL TO AMEND THE FEDERAL COAL LEASING AMENDMENTS ACT OF 1976, AND FOR OTHER PURPOSES

NOVEMBER 8, 1985

Printed for the use of the
Committee on Energy and Natural Resources

S. HRG. 99-417

AMENDING THE MINERAL LANDS LEASING ACT OF 1920, AND OTHER COAL RELATED ISSUES

HEARING

BEFORE THE

SUBCOMMITTEE ON
NATURAL RESOURCES DEVELOPMENT AND
PRODUCTION

OF THE

COMMITTEE ON
ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

ON

S. 372

A BILL TO AMEND THE MINERAL LANDS LEASING ACT OF 1920, AND FOR OTHER PURPOSES

S. 570

A BILL TO AMEND THE MINERAL LANDS LEASING ACT OF 1920 TO IMPROVE THE ADMINISTRATION OF THE FEDERAL COAL LEASING PROGRAM, AND FOR OTHER PURPOSES

S. 913

A BILL TO AMEND THE MINERAL LANDS LEASING ACT OF 1920 TO IMPROVE THE ADMINISTRATION OF THE FEDERAL COAL LEASING PROGRAM, AND FOR OTHER PURPOSES

S. 946

A BILL TO AMEND THE FEDERAL COAL LEASING AMENDMENTS ACT OF 1976, AND FOR OTHER PURPOSES

NOVEMBER 8, 1985

Printed for the use of the
Committee on Energy and Natural Resources

U.S. GOVERNMENT PRINTING OFFICE
57-000 O WASHINGTON : 1986

I

COMMITTEE ON ENERGY AND NATURAL RESOURCES

JAMES A. McCLURE, Idaho, *Chairman*

MARK O. HATFIELD, Oregon
LOWELL P. WEICKER, Jr., Connecticut
PETE V. DOMENICI, New Mexico
MALCOLM WALLOP, Wyoming
JOHN W. WARNER, Virginia
FRANK H. MURKOWSKI, Alaska
DON NICKLES, Oklahoma
CHIC HECHT, Nevada
DANIEL J. EVANS, Washington

J. BENNETT JOHNSTON, Louisiana
DALE BUMPERS, Arkansas
WENDELL H. FORD, Kentucky
HOWARD M. METZENBAUM, Ohio
JOHN MELCHER, Montana
BILL BRADLEY, New Jersey
JEFF BINGAMAN, New Mexico
JOHN D. ROCKEFELLER IV, West Virginia

FRANK M. CUSHING, *Staff Director*
GARY G. ELLSWORTH, *Chief Counsel*
D. MICHAEL HARVEY, *Chief Counsel for the Minority*

SUBCOMMITTEE ON NATURAL RESOURCES DEVELOPMENT AND PRODUCTION

JOHN W. WARNER, Virginia, *Chairman*

LOWELL P. WEICKER, Jr., Connecticut
MALCOLM WALLOP, Wyoming
FRANK H. MURKOWSKI, Alaska
DON NICKLES, Oklahoma

JOHN MELCHER, Montana
DALE BUMPERS, Arkansas
JEFF BINGAMAN, New Mexico
JOHN D. ROCKEFELLER IV, West Virginia

JAMES A. McCLURE and J. BENNETT JOHNSTON are Ex Officio Members of the Subcommittee

PATRICK SULLIVAN, *Professional Staff Member*

CONTENTS

Page
S. 372 3
S. 570 15
S. 913 21
S. 946 23
Amendments to S. 570 25

STATEMENTS

Bardacke, Paul, attorney general, State of New Mexico 97
Bingaman, Hon. Jeff, a U.S. Senator from the State of New Mexico 35
Brown, B.R. chairman and chief executive officer, Consolidation Coal Co 193
Ewing, Wayne, president, Peabody Development Co 191
Ford, Hon. Wendell H., a U.S. Senator from the State of Kentucky 36
Garner, Hugh C., attorney at law, Hugh Garner & Associates, on behalf of the Blackhawk Coal Co 346
Griles, J. Steven, Deputy Assistant Secretary, Land and Minerals Management, Department of the Interior 40
Hecht, Hon. Chic, a U.S. Senator from the State of Nevada 26
Holsten, Richard, chairman and president, Pittsburg & Midway Coal Mining Co 112
Mahaffey, Jack, president, Shell Mining Co 189
Masselli, David, Washington counsel, Western Organization of Resource Councils 272
McClure, Hon. James A., a U.S. Senator from the State of Idaho 28
McCormick, John L., Environmental Policy Institute 237
Melcher, Hon. John, a U.S. Senator from the State of Montana 37
Olson, E.K., president and general manager, Colowyo Coal Co 362
Thompson, G.W., president, Meridian Minerals Co 125
Wallop, Hon. Malcolm, a U.S. Senator from the State of Wyoming 1
Warner, Hon John W., a U.S. Senator from the State of Virginia 32
Williams, Kenneth L., director, government affairs, Western Energy Co 356
Wilson, James C., president, Rocky Mountain Energy 140
Winterer, T.R., senior vice president and manager, U.S. Mining Operations, Utah International, Inc 187
Yeager, Brocks B., Washington representative, the Sierra Club 249
Zitting, Richard T., president, SF Minerals Corp 115

APPENDIXES

Appendix I

Responses to additional committee questions 375

Appendix II

Additional material submitted for the record 725

AMENDING THE MINERAL LANDS LEASING ACT OF 1920, AND OTHER COAL RELATED ISSUES

FRIDAY, NOVEMBER 8, 1985

U.S. Senate,
Subcommittee on Natural Resources
Development and Production,
Committee on Energy and Natural Resources,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:32 a.m., in room SD-366, Dirksen Senate Office Building, Hon. Malcolm Wallop, presiding.

Present: Senators Wallop, McClure, Domenici, Hecht, Johnston, Ford, Melcher, and Bingaman.

Also present: Patrick Sullivan, professional staff member; and Patricia J. Beneke, counsel for the minority.

OPENING STATEMENT OF HON. MALCOLM WALLOP, A U.S. SENATOR FROM THE STATE OF WYOMING

Senator **Wallop**. Good morning. We have a sort of tag team chairing arrangement for the hearing this morning, but with the level of interest of various parties, both sides have agreed to alternate chairing this hearing because of the importance of it.

I must admit that I am walking an ever so fine line between pain and pleasure over the prospect—and now the reality—of finally conducting this hearing.

Make no mistake about it; I am pleased to be here. And yet, I am pained and frustrated that it's taken so long to gather all of the interested parties in one room to openly and publicly discuss and debate the problems, issues, and solutions involved in adjusting the changes made by the 1976 Federal Coal Leasing Amendments Act to section 2(a) and section 7 of the Mineral Leasing Act.

I introduced S. 570 almost 8 months ago because I was and still am convinced that August 4, 1986, has the potential of leveling a devastating blow, not only at America's coal industry but to the future energy security of our country, and no less an extent to the economic security of my home State of Wyoming.

To focus this point, I'll briefly mention several observations contained in the Bureau of Land Management's September 1985 "Analysis of Options for Amending the Mineral Leasing Act, Sections 2(a), 2(A), and 7."

The report finds that out of the total pre-1976 leases, close to half will fail the 1976 section 3 criteria. This represents about 5.23 billion tons, or almost 35 percent of recoverable coal reserves from all of the pre-1976 leases. Most of these leases are in Utah, Wyoming, Colorado, and some of the Eastern States; yet, almost half of the reserve tonnage is located in Wyoming.

These lease and tonnage figures do not include other leases affected by section 7. Here we're talking about 129 leases and about 3.16 billion tons of recoverable reserves, and again most of the affected tonnage lies in the States of Wyoming and Utah.

For 2 years now, since first introducing S. 1634, a bill to repeat section 3 of the 1976 law, I have maintained a constant state of high anxiety whenever the August 1986 deadline is mentioned in my presence. The prospect of virtually shutting down the Federal Mineral Leasing Program, combined with the likelihood of noncomplying coal leases being relinquished under various off-market conditions, and Treasury II's proposal to repeal the percentage depletion for the mining industry only contributes to my anxiety level.

I suppose, as far as anxiety levels are concerned, I can empathize with those here today who may express a similar reaction over any discussion of repealing or modifying subsection 2(c) of the Mineral Leasing Act.

I will state for the record that I have supported Senator McClure's efforts in this area, but still reserve my primary level of anxiety over the 1986 deadline and want to diligently pursue what we have at long last started today.

It is my hope that the interest, enthusiasm, and courage for a reasonable and timely resolution can still be generated by all affected aspects of America's energy industry, including the oil and gas industry which has chosen not to send a witness today, even though according to the Bureau of Land Management more than 46 percent of the noncomplying section 3 leases are held by entities involved in oil and gas production, either directly or through an affiliate.

Your absence at the witness table and presence at the back of the room during a hearing addressing section 3 issues has been noted.

Finally, as much as an issue involving the ultimate continuation of our Federal Mineral Leasing Program should ideally draw all parties together for the sake of America's energy security, it can all too predictably break down into individual, corporate, regional, and even political interests.

Also, the more comfortable we become in deceiving ourselves that we are an energy-independent Nation, the more we are unable to craft a practical and consistent energy policy.

This Senator has been here long enough as a member of both the Finance and Energy Committees to recognize two aspects of tough decisions: Capitalists usually aren't, and Congress isn't usually consistent.

Recognizing the nature of those beasts, I want to get this section 3 and section 7 question resolved once and for all. I believe repealing section 3 is the best route to travel, as is the concept of an advance escalating royalty holding fee to distinguish the idle speculator from the serious developer.

We're only just beginning, but it is a beginning and I look forward to working with my colleagues and members of the industry in pursuing a rapid and final decision.

[The texts of S. 372, S. 570, S. 913, S. 946, and amendments No.'s 801 and 802 to S. 570 follow:]

II

99TH CONGRESS
1ST SESSION

S. 372

To amend the Mineral Lands Leasing Act of 1920, and for other purposes.

IN THE SENATE OF THE UNITED STATES

JANUARY 31 (legislative day, JANUARY 21), 1985

Mr. JOHNSTON introduced the following bill; which was read twice and referred to the Committee on Energy and Natural Resources

---

A BILL

To amend the Mineral Lands Leasing Act of 1920, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) this Act may be referred to as the "Federal Coal Leasing Amendments Act of 1985".

(b) Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to or repeal of, a section or other provision of the Mineral Lands Leasing Act, the reference shall be considered to be made to a section or other provision of the Act of February 25, 1920, entitled "An Act to promote the mining of

★(Star Print)

coal, phosphate, oil, oil shale, gas, and sodium on the public domain" (41 Stat. 437).

Sec. 2. Section 2(a)(2) of the Mineral Lands Leasing Act (30 U.S.C. 201(a)(2)) is amended by deleting subparagraph (A) and inserting in lieu thereof the following:

"(A)(i) The Secretary shall not issue a lease or leases to coal deposits under the terms of this section to any person, association, corporation, or any subsidiary, affiliate, or persons controlled by or under common control with such person, association, or corporation, where any such entity holds a lease or leases issued prior to August 4, 1976, by the United States to coal deposits and has held such lease or leases for a period of ten years when such entity is not, except as provided in section 7(b) of this Act, producing coal from the leased deposits in commercial quantities. In computing the ten-year period referred to in the preceding sentence, periods of time prior to August 4, 1976, shall not be counted.

"(ii) The prohibition in subparagraph (A)(i) shall not apply if such entity agrees to relinquish a noncompliance coal lease or leases issued pursuant to this Act containing estimated recoverable coal reserves equivalent to the estimated recoverable coal reserves from the lease or leases being issued. To the extent coal reserves relinquished under this subparagraph exceed the coal reserves to be acquired, the entity with the approval of the Secretary may, for the purposes of complying with this section, apply the amount of excess reserves toward future competitive lease sales.

"(iii) The prohibition in subparagraph (a)(i) shall not apply if such entity holds no more than two noncompliance leases issued prior to August 4. 1976, and pays an additional rental on those coal deposits being acquired.

"(iv) For the purposes of this section, the term 'noncompliance lease' means a coal lease issued prior to August 4, 1976, which has been held by the lessee for a period of ten years and has not produced coal from the lease deposits in commercial quantities. The number of acres on which the fee is assessed shall not exceed the number of acres within the noncompliance lease held by the lessee.

"(v) The additional rental set forth in subparagraph (A)(iii) shall be assessed on the following basis:

"(I) an entity acquiring a coal lease with estimated recoverable reserves of coal up to one hundred million tons would pay an additional rental of $25 per acre for such lease;

"(II) an entity acquiring a coal lease with estimated recoverable reserves of coal of one hundred million tons or more but less than three hundred million tons would pay an additional rental of $35 per acre for such lease; and

"(III) an entity acquiring a coal lease with estimated recoverable reserves of coal of over three hundred million tons would pay an additional rental of $45 per acre for such lease.

"(iv) Estimations of acreage or recoverable reserves necessary to determine the terms of relinquishment or the rental assessed under subparagraph (A)(v) shall be based on the Secretary's estimate of recoverable coal reserves without regard to quality or location.

"(vii) Notwithstanding any other provision of this Act, the Secretary shall accept the relinquishment by the lessee of any coal lease or leases issued prior to August 4, 1976, where there has not been significant surface disturbance pursuant to a permit issued under section 506 of the Surface Mining Control and Reclamation Act of 1977 (30 U.S.C. 1256).

"(viii) The prohibition on the Secretary issuing coal leases under subparagraph (A)(i) shall not apply to an entity that has met the conditions set forth under subparagraphs (A)(ii), or (A)(iii) or (A)(vii) regarding the relinquishment of noncompliance coal leases, the payment of an additional rental, or the relinquishment of leases issued prior to August 4, 1976.".

SEC. 3. (a) Section 7 of the Mineral Lands Leasing Act (30 U.S.C. 207) is amended to read as follows:

"SEC. 7. (a) A coal lease shall be for a term of twenty years and for so long thereafter as the condition of continued operation is met. The Secretary shall by regulation prescribe annual rentals on leases. A lease shall require payment of a royalty in such amount as the Secretary shall determine of not less than 12.5 per centum of the value of coal as defined by regulation, except the Secretary may determine a lesser amount in the case of coal recovered by underground mining operations. The lease shall include such other terms and conditions as the Secretary shall determine. Such rentals and royalties and other terms and conditions of the lease will be subject to readjustment at the end of its primary term of twenty years and at the end of each ten-year period thereafter if the lease is extended. With respect to a lease issued prior to August 4, 1976, upon the effective date of the first readjustment after the date of enactment of the Federal Coal Leasing Amendments Act of 1985, the amount of the royalty required to be paid under such lease shall be readjusted automatically by operation of law to a rate of not less than 12.5 per centum of the value of coal for surface mined coal, and to a rate of not less than 8 per centum in the case of coal recovered by underground mining operations.

"(b)(1) A lease that is not producing coal in commercial quantities at the end of ten years shall be terminated unless the lessee chooses to extend the lease beyond the tenth lease year through the payment of advance royalties.

"(2) Such advance royalties shall be no less than the production royalty which would otherwise be paid and shall be assessed on an escalating basis as follows:

"(A) in the eleventh lease year, an advance royalty would be assessed on assumed production of 0.1 per centum of total recoverable reserves;

"(B) in the twelfth lease year, an advance royalty would be assessed on assumed production of 0.2 per centum of total recoverable reserves;

"(C) in the thirteenth lease year, an advance royalty would be assessed on assumed production of 0.3 per centum of total recoverable reserves;

"(D) in the fourteenth lease year, an advance royalty would be assessed on assumed production of 0.4 per centum of total recoverable reserves;

"(E) in the fifteenth lease year, an advance royalty would be assessed on assumed production of 0.5 per centum of total recoverable reserves;

"(F) in the sixteenth lease year, an advance royalty would be assessed on assumed production of 0.6 per centum of total recoverable reserves;

"(G) in the seventeenth lease year, an advance royalty would be assessed on assumed production of 0.7 per centum of total recoverable reserves;

"(H) in the eighteenth lease year, an advance royalty would be assessed on assumed production of 0.8 per centum of total recoverable reserves;

"(I) in the nineteenth lease year, an advance royalty would be assessed on assumed production of 0.9 per centum of total recoverable reserves; and

"(J) in the twentieth lease year, an advance royalty would be assessed on assumed production of 1 per centum of total recoverable reserves.

"(3) Payment by a lessee of advance royalties under subsection (b) of this section shall constitute compliance with Section 2(a)(2)(A) of the Mineral Lands Leasing Act (30 U.S.C. 201(a)(2)(A)).

"(4) The payment of any advance royalty by the lessee for any year in which production of lease reserves exceeds commercial quantities, as this term is defined in section 7(e) of this Act, may be credited against production, to the extent that such production exceeds commercial quantities.

"(c) Each lease shall be subject to the conditions of diligent development and continued operation of the mine or mines except where operations under the lease are interrupted by strikes, the elements, or casualties not attributable to the lessee. The Secretary of the Interior, upon determining that the public interest will be served thereby, may suspend the condition of continued operation upon the payment of advance royalties. Such advance royalties shall be no less than the production royalty which would otherwise be paid and shall be computed on a fixed reserve to production ratio (determined by the Secretary). The aggregate number of years during the period of any lease for which advance royalties may be accepted in lieu of the condition of continued operation shall not exceed ten. The amount of any production royalty paid to suspend the condition of continued operation for any year shall be reduced (but not below zero) by the amount of any advance royalties paid under such lease to the extent that such advance royalties have not been used to reduce production royalties for a prior year. No advance royalty paid during the initial twenty-year term of a lease shall be used to reduce a production royalty after the twentieth year of a lease. The Secretary may, upon six months' notification to the lessee cease to accept advance royalties in lieu of the requirement of continued operation. Nothing in this subsection, with the exception of payment of advance royalties in lieu of production, shall be construed to affect the requirement contained in subsection (b)(1) relating to commencement of production at the end of ten years.

"(d) Prior to taking any action on a leasehold which might cause a significant disturbance of the environment, the lessee shall submit for the Secretary's approval an operation and reclamation plan. The Secretary shall approve or disapprove the plan or require that it be modified. Where the land involved is under the surface jurisdiction of another Federal agency, that other agency must consent to the terms of such approval.

"(e) For the purposes of this Act, with respect to leases issued to coal deposits or readjusted after the date of enactment of the Federal Coal Leasing Amendments Act of 1985, the term—

"(1) 'commercial quantities' means one per centum of the recoverable coal reserves under lease or within a logical mining unit (LMU);

"(2) 'diligent development' means the production of recoverable coal reserves in commercial quantities; and

"(3) 'continued operation' means the production of not less than commercial quantities of recoverable coal reserves in each year following the achievement of diligent development and an average amount of not less than commercial quantities of recoverable reserves each year thereafter, computed on a three-year basis consisting of the year in question and the two preceeding years.".

SEC. 4. Section 2(a)(1) of the Mineral Lands Leasing Act (30 U.S.C. 201(a)) is amended by inserting after the first sentence, the following: "For purposes of this subsection, the term 'competitive bidding' shall mean the receipt of bids by two or more bidders, with the exception of bidding for a maintenance or bypass lease as defined in regulation.".

SEC. 5. Section 2 of the Mineral Lands Leasing Act (30 U.S.C. 201(a)) is amended by inserting the following new subsections and renumbering thereafter, accordingly:

"(a)(3) The Secretary shall promulgate rules and regulations to provide for experimentation with the negotiated sale of leases for bypass and maintenance tracts as defined by the Secretary. Such rules and regulations as are necessary shall be published in the Federal Register within six months after the date of enactment of the Federal Coal Leasing Amendments Act of 1985.

"(4)(A) Notwithstanding any other provision of law, neither the Secretary nor any other officer, employee, contractor or agent of the Department of the Interior or bureau or agency thereof, shall disclose to anyone who is not an employee, contractor or agent of the Department of the Interior or bureau or agency any data developed by the Department of the Interior for estimating coal tract value.

"(B) Any Federal employee, contractor or agent of the Department, including the Secretary, who willfully violates subsection (a)(4)(A) shall be guilty of a crime and subject to the penalties set forth in section 1905 of title 18, United States Code.".

SEC. 6. The Mineral Lands Leasing Act (30 U.S.C. 208–2) is amended by adding after section 8B the following new section 8C:

"SEC. 8C. The Comptroller General of the General Accounting Office shall monitor the management, supervision, and enforcement relating to the leasing and production of coal on coal lands subject to this Act for a period of five years after the date of enactment of the Federal Coal Leasing Amendments Act of 1985, and shall report his findings with respect to these activities in a semiannual report to the Congress beginning six months after the date of enactment of the Federal Coal Leasing Amendments Act of 1985.".

SEC. 7. Section 30 of the Mineral Lands Leasing Act (30 U.S.C. 187) is amended by inserting after the first sentence thereof the following: "Within one hundred and eighty days of enactment of the Federal Coal Leasing Amendments Act of 1985, the Secretary of the Interior shall promulgate regulations which require, prior to his approval of any transfer of a record title interest or assignment of operating rights in a lease, that the transferor submit to the Secretary of the

Interior a financial document describing the consideration or value paid or promised for the transfer. Such regulations shall set forth both the extent and type of the information required to be filed in such financial document.".

○

II

99TH CONGRESS
1ST SESSION

S. 570

To amend the Mineral Lands Leasing Act of 1920 to improve the administration of the Federal coal leasing program, and for other purposes.

IN THE SENATE OF THE UNITED STATES

MARCH 5 (legislative day, FEBRUARY 18), 1985

Mr. WALLOP introduced the following bill; which was read twice and referred to the Committee on Energy and Natural Resources

---

A BILL

To amend the Mineral Lands Leasing Act of 1920 to improve the administration of the Federal coal leasing program, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) this Act may be cited as the "Mineral Lands Leasing Act Amendments of 1985".

(b) Any amendment or repeal in this Act expressed in terms of an amendment to or repeal of, a section or other provision of the Mineral Lands Leasing Act, shall be considered to be a reference to a section or other provision of the Act of February 25, 1920, entitled "An Act to promote the mining of coal, phosphate, oil, oil shale, gas, and sodium on the public domain" (41 Stat. 437).

Sec. 2. Section 2(a)(2) of the Mineral Lands Leasing Act (30 U.S.C. 201(a)(2)) is amended by striking out subparagraph (A) and redesignating subparagraph (B) as paragraph (2).

Sec. 3. The last sentence of section 2(d)(1) of the Mineral Lands Leasing Act (30 U.S.C. 202a(1)) is amended by striking out the comma after "single operator" and inserting in lieu thereof "and" and by striking out "and be contiguous".

Sec. 4. Section 2(a) of the Mineral Lands Leasing Act (30 U.S.C. 201(a)) is amended by inserting at the end thereof the following:

"(4) The Secretary shall promulgate rules and regulations to provide for experimentation with the negotiated sale of leases for bypass and maintenance tracts as defined by the Secretary. Such rules and regulations as are necessary shall be published in the Federal Register within six months after the date of enactment of the 'Mineral Land Leasing Act Amendments of 1985'."

Sec. 5. Section 2(d)(2) of the Mineral Lands Leasing Act (30 U.S.C. 202a(2)) is amended by striking out "which shall not be more than forty years".

SEC. 6. Section 7 of the Mineral Lands Leasing Act (30 U.S.C. 207) is amended to read as follows:

"SEC. 7. (a) A coal lease shall be a term of twenty years and for so long thereafter as the condition of continued operation and diligent development are met. The Secretary shall by regulation prescribe annual rentals on leases. A lease shall require payment of a royalty in such amount as the Secretary shall determine of not less than 12 1/2 per centum of the value of coal as defined by regulation, except the Secretary may determine a lesser amount in the case of coal recovered by underground mining operations. The lease shall include such other terms and conditions as the Secretary shall determine. Such rentals and royalties and other terms and conditions of the lease shall be subject to readjustment at the end of its primary term of twenty years and at the end of each ten-year period thereafter if the lease is extended.

"(b)(1) A lease that is not producing coal in commercial quantities at the end of ten years shall be terminated unless the lessee chooses to extend the lease beyond the 10th lease year through the payment of advance royalties.

"(2) Such advance royalties shall be assessed on an escalating basis as follows:

"(A) in the 11th lease year, an advance royalty would be assessed on assumed production of .1% of total recoverable reserves;

"(B) in the 12th lease year, an advance royalty would be assessed on assumed production of .2% of total recoverable reserves;

"(C) in the 13th lease year, an advance royalty would be assessed on assumed production of .3% of total recoverable reserves;

"(D) in the 14th lease year, an advance royalty would be assessed on assumed production of .4% of total recoverable reserves;

"(E) in the 15th lease year, an advance royalty would be assessed on assumed production of .5% of total recoverable reserves;

"(F) in the 16th lease year, an advance royalty would be assessed on assumed production of .6% of total recoverable reserves;

"(G) in the 17th lease year, an advance royalty would be assessed on assumed production of .7% of total recoverable reserves;

"(H) in the 18th lease year, an advance royalty would be assessed on assumed production of .8% of total recoverable reserves;

"(I) in the 19th lease year, an advance royalty would be assessed on assumed production of .9% of total recoverable reserves; and

"(J) in the 20th lease year, an advance royalty would be assessed on assumed production of 1.0% of total recoverable reserves.

"(3) Payment by lessee of advance royalties under subsection (b) shall constitute compliance with section 2(a)(2)(A) of the Mineral Lands Leasing Act (30 U.S.C. 201(2)(A)).

"(4) The payment of any advance royalty by the lessee for any year in which production of lease reserves exceeds commercial quantities may be credited against production, to the extent that such production exceeds commercial quantities.

"(c) Each lease shall be subject to the conditions of diligent development and continued operation of the mine or mines, except where operations under the lease are interrupted by strikes, the elements, or casualties not attributable to the lessee. The Secretary of the Interior, upon determining that the public interest will be served thereby, may suspend the condition of continued operation upon the payment of advance royalties. Such advance royalties shall be no less than the production royalty which would otherwise be paid and shall be computed on a fixed reserve to production ratio (determined by the Secretary). The aggregate number of years during the period of any lease for which advance royalties may be accepted in lieu of the condition of continued operation shall not exceed ten. The amount of any production royalty paid to suspend the condition of continued operation for any year shall be reduced (but not below 0) by the amount of any advance royalties paid under such lease to the extent that such advance royalties have not been used to reduce production royalties for a prior year. No advance royalty paid during the initial twenty-year term of a lease shall be used to reduce a production royalty after the twentieth year of a lease. The Secretary may, upon six months' notification to the lessee cease to accept advance royalties in lieu of the requirement of continued operation. Nothing in this subsection, with the exception of payment of advance royalties in lieu of production, shall be construed to affect the requirement contained in subsection (b)(1) relating to commencement of production at the end of ten years.

"(d) Prior to taking any action on a leasehold which might cause a significant disturbance of the environment, the lessee shall submit for the Secretary's approval an operation and reclamation plan. The Secretary shall approve or disapprove the plan or require that it be modified. Where the land involved is under the surface jurisdiction of another Federal agency, that other agency must consent to the terms of such approval.".

○

II

99TH CONGRESS
1ST SESSION

S. 913

To amend the Mineral Lands Leasing Act of 1920 to improve the administration of the Federal coal leasing program, and for other purposes.

IN THE SENATE OF THE UNITED STATES

APRIL 16 (legislative day, APRIL 15), 1985

Mr. FORD introduced the following bill; which was read twice and referred to the Committee on Energy and Natural Resources

---

A BILL

To amend the Mineral Lands Leasing Act of 1920 to improve the administration of the Federal coal leasing program, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) this Act may be cited as the "Mineral Lands Leasing Act Amendments of 1985".

(b) Any amendment or repeal in this Act expressed in terms of an amendment to or repeal of, a section or other provision of the Mineral Lands Leasing Act, shall be considered to be a reference to a section or other provision of the Act of February 25, 1920, entitled "An Act to promote the mining of coal, phosphate; oil, oil shale, gas, and sodium on the public domain" (41 Stat. 437).

Sec. 2. Section 2(a)(2) (30 U.S.C. 201(a)(2)) of the Mineral Lands Leasing Act is amended by deleting subparagraph (A) and by inserting in lieu thereof the following:

"(A) The Secretary shall not issue a competitive coal lease or leases under the terms of section 2(a) of the Mineral Lands Leasing Act (30 U.S.C. 201(a)), to any person, association, corporation, or any subsidiary, affiliate, or persons controlled by or under common control with such person, association, or corporation, where any such entity holds a lease or leases issued prior to August 4, 1976, by the United States to coal deposits and has held such lease or leases for a period of ten years when such entity is not, except as provided in section 7(b) of this Act, producing coal from the lease deposits in commercial quantities. In computing the ten-year period referred to in the preceding sentence, periods of time prior to August 4, 1976, shall not be counted.".

○

II

99TH CONGRESS
1ST SESSION

S. 946

To amend the Federal Coal Leasing Amendments Act of 1976, and for other purposes.

IN THE SENATE OF THE UNITED STATES

APRIL 18 (legislative day, APRIL 15), 1985

Mr. FORD introduced the following bill; which was read twice and referred to the Committee on Energy and Natural Resources

---

A BILL

To amend the Federal Coal Leasing Amendments Act of 1976, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be referred to as the "Federal Competitive Coal Leasing Amendments Act of 1985".

SEC. 2. Section 2(a) of the Mineral Lands Leasing Amendments Act of 1920 (30 U.S.C. 201(a)), as amended by section 3 of the Federal Coal Leasing Amendments Act of 1976 (30 U.S.C. 201(a)) is further amended by redesignating the last sentence as (2)(A)(i) and adding a new sentence 2(A)(ii) as follows:

"(2)(A)(ii) The Secretary shall not issue a competitive coal lease or leases under the terms of this section to any person, association, or corporation that is a subsidiary of, affiliated with, or controlled by or under common control with a person, association, or corporation engaged in the extraction or production of coal reserves in a foreign country, and the importation of such reserves into the United States."

○

McClure Amendment Nos. 801 and 802

(Ordered referred to the Committee on Energy and Natural Resources.)

Mr. McCLURE submitted two amendments intended to be proposed by him to the bill (S. 570) to amend the Mineral Lands Leasing Act of 1920 to improve the administration of the Federal Coal Leasing Program, and for other purposes; as follows:

AMENDMENT NO. 801

On page 2 after line 6 insert a new section 2 as follows and renumber succeeding sections accordingly:

SEC. 2. Section 2(c) of the Mineral Lands Leasing Act (30 U.S.C. 202) is amended to read as follows:

"(c)(1) A common carrier railroad company or any company that controls, is controlled by, or is under common control with such company (hereinafter in this subsection referred to as a "railroad or affiliated company") may hold leases of coal deposits pursuant to this Act subject to the special conditions on (i) lease bidding in paragraph (2); (ii) lease holdings in paragraph (3); and (iii) transportation of leased coal in paragraph (4).

"(2)(A) No railroad or affiliated company shall be eligible to bid or a lease under this Act of coal deposits that are adjacent to coal deposits which (i) are in lands granted by the United States to such railroad or affiliated company or to a corporate predecessor thereof and (ii) are owned by such company (hereinafter in this paragraph referred to as "the federal lease") unless such company notifies the Secretary of its intention to bid by a date, established by regulation, prior to the sale of the federal lease. Whenever such a notification has been received and a tract for the federal lease has been delineated, the Secretary shall identify a potential mining unit containing the federal lease (hereinafter in this paragraph referred to as "the potential mining unit") and, if he finds that competition for the federal lease would be substantially enhanced thereby, shall require as conditions to the right of the railroad or affiliated company to bid when and if the federal lease is offered for sale, that, prior to the sale, the railroad or affiliated company shall—

"(i) upon request, make available at reasonable cost to any potential bidder for the federal lease any and all exploration data in the possession of the company concerning the extent and nature of the land-grant coal deposits within the potential mining unit; and

"(ii) agree that, if not the successful bidder for the federal lease, it will offer for lease the land-grant coal deposits owned by the company in the potential mining unit on reasonable terms which are mutually agreed to by the Secretary and the company: *Provided*, That whenever the Secretary makes a finding of significant competition enhancement pursuant to this subparagraph (A), shall promptly enter into good faith negotiations with the railroad or affiliated company to establish such terms and shall not offer the federal lease until such terms are established or he and the company mutually agree in writing that the negotiations have concluded and no agreement on terms can be reached; in which latter event, the railroad or affiliated compeny shall not be eligible to bid on the federal lease: *Provided further*, That the Secretary may determine without company concurrence that no agreement on terms can be reached if, after publishing a complete statement of his final offer to the company in the *Federal Register* and allowing 30 days for a response, the company has failed to agree to such terms.

"(B) After notification to the Secretary pursuant to subparagraph (A), a railroad or affiliated company may bid upon the federal lease without the conditions specified in said subparagraph whenever the Secretary does not make a finding of significant competition enhancement as provided in subparagraph (A), or when the railroad or affiliated company has a less than thirty percent interest in a joint venture which would own or control the federal lease, or where the coal deposits to be included in the federal lease—

"(i) constitute less than thirty-five percent of the recoverable reserves in the potential mining unit; or

"(ii) would be bypassed by or are required to maintain ongoing mining operations owned in whole or in part by the railroad or affiliated company and located in the potential mining unit; or

"(iii) are within or adjacent to the permit area of a mining operation that is owned in whole or in part by the railroad or affiliated company and that is operating, and has coal committed to a purchase, prior to the date of enactment of this subsection.

"(3) Any railroad or affiliated company shall be subject to the acreage restrictions of section 27(a)(1) of this Act and, within these limitations, shall not take, hold, or control at one time, whether acquired directly from the Secretary or otherwise under this Act, leases of coal deposits adjacent to land-grant coal deposits which were granted by the United States to such railroad or affiliated company or to a corporate predecessor thereof and are owned by such company in an aggregate of more than twenty-three thousand and forty acres.

"(4)(A) Whenever a railroad or affiliated company obtains a lease under this Act of coal deposits situated within the exclusive service area of such railroad company, the railroad company may not thereafter enter into a contract to transport coal produced from said lease or from a mining unit that includes said lease (hereinafter in this paragraph referred to as "the Contract") except as provided in this paragraph.

"(B) In addition to any filing which may be required by any other provision of law, the railroad company shall submit the Contract to the Secretary, together with copies of any formal transportation bid notice or request from the purchaser of the coal to be transported pursuant to the Contract (hereinafter in this paragraph referred to as "the purchaser") to which the railroad company responded and all formal transportation bids submitted by the railroad company in response to such notice or request. The railroad or affiliated company shall also submit to the Secretary its supply contract with the purchaser. Within five days of submisssion of the Contract, the Secretary shall publish in the Federal Register notice of such submission including identification of the contracting parties, the affected lease, and the lessee. The Contract shall not become effective until thirty days after the date of such publication.

"(C) Within that same thirty-day period, any coal producer (hereinafter in this paragraph referred to as "the complainant") may file a complaint with the Secretary alleging that the Contract is in violation of law and that it prevented complainant from selling its coal to the purchaser in lieu of the coal to be transported pursuant to the Contract. The complainant shall submit with its complaint a copy of its coal supply bid to the purchaser and any other information necessary for the Secretary to make the disclosure determination provided for in this subparagraph. If the Secretary determines that (i) the purchaser requested and received a timely and responsive supply bid from the complainant, the terms of which were substantially similar to those of the supply contract, (ii) the complainant had no reasonable alternative transportation available for its coal except that supplied in whole or in part by the railroad company, (iii) the purchaser requested a bid from the railroad company to transport in whole or in part the complainant's coal, and (iv) the Contract and the bids, if any, submitted by the railroad company to transport the complainant's coal are not identical in all material respects, the Secretary shall disclose the submissions of the railroad or affiliated company to the complainant and the submissions of the complainant to the railroad company (and to its affiliated company, if the latter holds the lease to the coal to be transported pursuant to the Contract).

"(D) The submissions to the Secretary pursuant to this pargraph shall be disclosed by him only pursuant to subparagraph (C) and, except as provided in subparagraph (E), shall otherwise remain proprietary and not be released to any other person or entity, any other provision of law notwithstanding.

"(E) The complainant may make use of the submissions of the railroad or affiliated company solely for the purpose of determining whether a cause of action may exist against the railroad or affiliated company and disclose such submissions solely for the purpose of prosecuting such cause of action. The railroad or affiliated company may make use of and disclose the submissions of the complainant solely for the purpose of defending such cause of action. No other disclosure or use may be made of such submissions."

AMENDMENT NO. 802

On page 2 after line 6 insert a new section 2 as follows and renumber succeeding sections accordingly:

"SEC. 2. Subsection 2(c) of the Mineral Lands Leasing Act (41 Stat. 438), as amended, is hereby repealed".

Senator WALLOP. Senator Hecht, do you have any remarks?

STATEMENT OF HON. CHIC HECHT, A U.S. SENATOR FROM THE STATE OF NEVADA

Senator HECHT. Thank you, Mr. Chairman. I'm happy to be here today and to learn a lot more about the coal industry. We don't have any coal development in our State, but it's a big part of America, so I want to hear from you.

Senator WALLOP. Thank you, Senator Hecht.

I have an opening statement of the chairman of this subcommittee, Senator Warner, who was called away on the obvious emergencies created by the floodwaters in his State, and we wish him well in dealing with the personal tragedies that are so numerous in that State.

I also have an opening statement of the chairman of the committee, Senator McClure, which I wish to have inserted in the record here.

[The prepared statements of Senator McClure and Senator Warner follow:]

OPENING STATEMENT OF SENATOR JAMES A. MCCLURE

I would like to thank the Subcommitte Chairman, my distinguished colleague, Senator Warner, for scheduling these long-awaited hearings on coal leasing legislation before this Committee.

On October 17 of this year, I introduced two amendments to Senator Wallop's bill S. 570, one of which is outright repeal of Section 2(c) of the MLLA, and the other reforms this archaic provision of the law.

Section 2(c) of the MLLA, currently prohibits a company operating a common carrier railroad from holding Federal coal leases, unless the coal is used for railroad purposes. While the legislative history of this provision was originally based upon the concern that western railroads would dominate the production of coal if permitted to hold Federal coal leases, it is obvious to me and the Departments of the Interior and Justice that this provision is no longer necessary. A statement made by the Justice Department in their 1980 report, which was prepared in connection with its responsibility to provide an annual assessment of competition in the coal industry under the Federal Coal Leasing Amendments Act of 1976, reads as follows:

> "Plainly, whatever the merits of a general prohibition on leasing to railroads in 1920, the broad sweep of Section 2(c) is now an impediment to rather than a bulwark (sic) of competition."

And further that:

> "Competitive concerns embodied in Section 2(c) could be handled on a case-by-case basis under the antitrust review procedure

without the detrimental effect on competition that arises from prohibiting Federal coal leasing to all railroads."

Not only do the statements by Justice compel me to offer this amendment, but also an opinion and legal interpretation of 2(c) rendered by both the Interior and Justice Departments respectively. In that opinion and legal interpretation, it was determined that the barrier of Section 2(c) also extends to companies that are separate from but affiliated with railroads as part of a corporate holding company structure.

I should also point out that in the report prepared by the Linowes Commission on Fair Market Value Policy for Federal Coal Leasing in 1984 concluded that ". . . steps should be taken to facilitate development of coal in railroad checkerboard areas. The current ownership patterns in these areas, combined with restrictions on railroad purchase of Federal leases, have impeded development." Interestingly enough, this same report is also referred to by the coal industry to justify other changes to the MLLA that they believe are important, many of which are Reflected in S. 570.

Although I ultimately support the outright repeal of 2(c), I understand that certain checks and balances may have to be put in place to assure equal treatment in the marketplace by the railroads when dealing with the coal companies and the railroad affiliated coal companies. With this attitude in mind, I introduced my second amendment which is a reform of 2(c). This reform has demonstrated to me how far the railroad affilates are willing to go in attempting to address the various concerns which have arisen with respect to outright repeal. I do, however, want to emphasize that this reform is certainly not a final product in any sense and does not represent the views of any one organization. It does represent a good working document which will be used to try to focus the discussion on the details of this reform and hopefully avoid the useless sophistry which opponents have resorted to in their effort to prevent any consideration of Section 2(c).

At the outset of this year, I requested the concerned organizations -- the railroads and the coal companies, as well as other interested groups -- to sit down and discuss their concerns and determine if reform of the 2(c) prohibition could be accomplished rather than outright repeal. Quite frankly, I have been surprised by how forthcoming and accomodating the railroad affiliates have been in attempting to lay out a basis for discussion. But I am not surprised, although certainly displeased, with the attitude of some in the industry who are totally intransigent on this subject. Unfortunately, the coal industry has not only rejected any reform proposal, but in doing so have offered no meaningful suggestions as to how the amendment might be modified to satisfy their concerns, other than a suggestion to amend the Staggers Rail Act, over which this Committee does not have primary jurisdiction.

I might add, the Commerce Committee held hearings on Monday dealing with the Staggers Rail Act transportation issue. Section 2(c) is a leasing issue, not a transportation issue. To contend that 2(c) is a transportation issue, clouds the issue which serves to inhibit its ability to get resolved. It should be noted that the Linowes Commission examined and dismissed the transportation concerns that were raised by the coal industry during the Commission's deliberations on the 2(c) issue.

It is long past time to realize that we are no longer living in 1920. Every major independent review of continued need for Section 2(c) has recommended its repeal -- the Public Land Law Review Commission, the Linowes Commission Report, the Department of Interior, the Department of Justice and both Republican and Democratic Administrations. It is long past time for Congress to act.

OPENING STATEMENT OF SENATOR JOHN WARNER

COMMITTEE ON ENERGY AND NATURAL RESOURCES
SUBCOMMITTEE ON NATURAL RESOURCES DEVELOPMENT AND PRODUCTION
NOVEMBER 8, 1985, 9:30 A.M. IN ROOM SD-366

TODAY THE SUBCOMMITTEE WILL HEAR TESTIMONY CONCERNING THE PROBLEMS SURROUNDING SECTION 3 AND SECTION 7 OF THE FEDERAL COAL LEASING AMENDMENTS ACT OF 1976 (FCLAA). SECTION 3 PROHIBITS THE SECRETARY OF THE INTERIOR FROM ISSUING ANY FEDERAL MINERAL LEASE TO A LESSEE WHO HOLDS AND HAS HELD A COAL LEASE FOR TEN YEARS AND IS NOT PRODUCING COAL IN COMMERCIAL QUANTITIES. THIS REQUIREMENT COULD IMPACT ABOUT 400 OF THE EXISTING 619 FEDERAL COAL LEASES. SECTION 7 PROVIDES THAT A LEASE ISSUED AFTER PASSAGE OF FCLAA WILL BE TERMINATED IF COAL IS NOT BEING PRODUCED IN COMMERCIAL QUANTITIES AT THE END OF TEN YEARS. THESE PROVISIONS WERE THE RESULT OF CONGRESSIONAL CONCERN THAT FEDERAL COAL LEASES WERE NOT BEING DEVELOPED IN A REASONABLE PERIOD OF TIME AND WERE BEING HELD FOR SPECULATIVE PURPOSES.

CONGRESS ATTEMPTED TO STIMULATE PRODUCTION BY GIVING LESSEES TWO OPTIONS: EITHER PRODUCE OR FACE LOSS OF THE LEASE OR A PROHIBITION ON FURTHER LEASE ACQUISITIONS.

THE COMPLEXION OF AMERICA'S ENERGY MIX HAS CHANGED DRAMATICALLY SINCE THE ENACTMENT OF FCLAA IN 1976. AT THAT TIME, MANY BELIEVED NATURAL GAS RESERVES WERE BEING DEPLETED TOO RAPIDLY, AND NATURAL GAS WOULD ONLY BE AVAILABLE FOR A SHORT TERM. OTHERS PREDICTED THE PRICE OF OIL, (THEN $11 TO $12 A BARREL), WOULD SOAR TO 80 DOLLARS A BARREL, dramatically reducing its role in the energy picture because of its prohibitive price and uncertain availability from the Mideast. Nuclear power faced many complex licensing hurdles. The alternatives, such as solar, were still in the infant stages. Due to these concerns, Congress reacted strongly in the mid-70's to propel American coal to the forefront to meet predicted shortfalls in our Nation's energy supply.

But the energy situation in the U.S. today -- 9 years after the enactment of FCLAA -- is dramatically different. The world coal market is glutted, further aggravating the problems facing our domestic coal industry.

Today's hearing will focus on four pieces of legislation, S. 372, S. 570, S. 913, and S. 946, introduced by Senators Johnston, Wallop and Ford respectively. The Subcommittee will also consider two amendments to S. 570 introduced by Senator McClure. One amendment would reform Section 2(c) of the Mineral Lands Leasing Act of 1920, while the other would repeal it. As my colleagues know, Section 2(c) prohibits a company operating a common carrier railroad from holding Federal coal leases, unless the coal is used for railroad purposes. In addition, the Departments of Justice and Interior have recently interpreted Section 2(c) to prohibit subsidiaries, affiliates, or any person under control of a common carrier railroad from acquiring any Federal coal leases.

I SHOULD NOTE THE LINOWES COMMISSION REPORT ON FAIR MARKET VALUE PUBLISHED IN 1984 RECOMMENDED THE REPEAL OF SECTION 3 AND 2(C) AS HAVE PAST ADMINISTRATIONS.

OUR COUNTERPART IN THE HOUSE INTERIOR AND INSULAR AFFAIRS COMMITTEE, THE SUBCOMMITTEE ON MINING AND NATURAL RESOURCES HAS MARKED UP H.R. 1934, WHICH ADDRESS THE SECTION 3 AND 7 PROBLEMS.

I LOOK FORWARD TO THE TESTIMONY WHICH THE SUBCOMMITTEE WILL RECEIVE TODAY AND I HOPE THAT ON THE BASIS OF THE RECORD WHICH WE WILL DEVELOP WE WILL BE ABLE TO RECOMMEND APPROPRIATE SOLUTIONS TO THE PROBLEMS FACING US. I WELCOME ALL THE WITNESSES. YOUR FULL STATEMENTS WILL BE INCLUDED IN THE RECORD SO I ENCOURAGE YOU TO SUMMARIZE YOUR MAJOR POINTS.

Senator **Wallop**. John, did you want to testify at the witness table or here?

Senator **Melcher**. I'm going to testify at the table.

Senator **Wallop**. OK. Senator Bingaman.

STATEMENT OF HON. JEFF BINGAMAN, A U.S. SENATOR FROM THE STATE OF NEW MEXICO

Senator **Bingaman**. Let me just make a couple of comments, Mr. Chairman. I want to thank you for having a subcommittee hearing on this important issue. Obviously, the provisions in the existing law have caused concerns of many of us from coal-producing States. As you know, coal is an important natural resource in New Mexico and approximately 45 percent of New Mexico's coal reserves are estimated to lie under Federal lands.

Unfortunately, very little development has taken place on these lands in recent years, and I am sure that the attorney of our State, who is a witness today, will give some of the reasons for this limited development.

The key issue, obviously, as you pointed out in your statement is how we can improve the coal-leasing program on Federal lands and a first step is clearly to make some needed changes in the diligence laws, and I commend you for your proposal and I understand Senator Johnston has a similar proposal.

I support diligent development of Federal coal leases; however, I agree that existing law which imposes sanctions on companies that have noncomplying coal leases, by prohibiting those companies from obtaining any new leases in any other mineral, that those sanctions are too broad and that law needs to be changed.

So I look forward to the testimony today and I commend you for holding the hearing.

Senator **Wallop**. Thank you very much. I appreciate that.

Senator Melcher, would you join us at the witness table, please?

Senator **Bingaman**. Mr. Chairman, I also have a statement by Senator Ford which he would like to have inserted in the record if he could.

Senator **Wallop**. By all means. We'll have any other statements that Senators may wish to submit put in the record at the appropriate place.

[The prepared statement of Senator Ford follows:]

COAL LEASING
November 8, 1985

Statement by Senator Wendell H. Ford

I am pleased that we are here today to move forward with legislation pertaining to federal coal leasing. I have always viewed coal as a key component of our nation's energy policy. A strong and well-managed Federal Coal Leasing Program is a vital part of a strong domestic coal industry.

I have introduced two bills which would modify Section 2(a)(2)(A) of the Mineral Lands Leasing Act, also known as Section 3 of the Federal Coal Leasing Amendments Act. We are approaching the ten-year statutory deadline for production from pre-1976 leases. However, the slack coal market, transportation problems, and other reasons beyond the control of lessees has, in some instances, prevented production. My bill, S. 913, would continue to prohibit companies from obtaining more federal coal leases until they develop their currently held leases; however, it would remove the punitive features of the current law in that it would allow lessees to obtain leases for other non-coal minerals.

My second bill, S. 946, would prohibit U.S. companies involved in overseas production and exportation of foreign coal from obtaining new competitive federal coal leases. South American countries, such as Colombia, threaten gradually to capture a substantial share of our domestic coal market and the world export market. While I believe that changes to Section 3 are in order, our domestic coal resources should not go undeveloped while U.S. companies are producing coal overseas. My bill would help prevent this from happening.

Senator **Wallop**. Good morning, John. Welcome.

STATEMENT OF HON. JOHN MELCHER, A U.S. SENATOR FROM THE STATE OF MONTANA

Senator **Melcher**. Good morning.

Mr. Chairman and colleagues, I want to address a question of the repeal or modification of section 2(c). It just simply says that no company or corporation operating a common carrier railroad shall be given or hold a permit or lease for any coal deposits except for its own use as a railroad.

Now, that's a pretty inclusive section of law. The recent trend of railroads becoming holding companies has no bearing on what the language seeks to prohibit.

The history that brought about section 2(c), I believe goes back to the history of the land grants for railroads, and I'd like to speak a little bit in that regard. In our case in Montana, the land grant railroad was the Northern Pacific. It has now in recent years become part of the Burlington Northern, which in turn has become part of the overall holding company of Burlington, Inc.

The land grant to the Northern Pacific which is now part of the Burlington's holdings was given on the basis of every other section. On the restriction on the railroad mining coal except for its own use, in terms of leases from the United States, it was obviously a restriction to prevent a situation where the coal itself and the hauling of the coal were wrapped up into one company. We might call that a section of the law that was designed to foster competition.

I have noted in some of the testimony that will be given today some remarks to the effect that it's no longer needed; that it should be modified or repealed; that the circumstances are different. And to that point I'd like to say this: The antitrust provisions in regard to leases that are given on Federal minerals or allowed on Federal minerals is an antitrust review. We do have those restrictions in the Mineral Leasing Act, and it's good to have them there. But 2(c) really is narrow, it goes to a specific point; it is, in addition, not just part of antitrust, but specifically an addition to whatever the conditions of the antitrust enforcement would be necessary regarding various companies.

If 2(c) is to be termed just some sort of a prevention of a situation where there wouldn't be competition, let me express the major fear of Montana. It's a fear of control. It's a fear that the Burlington would control simply too much.

As the recipients of the land grant of vast amounts of land, and, therefore, vast potential minerals, the railroad itself, as the only railroad company that operates in our State, where we're dependent upon the common carrier offering or common carrier services of the Burlington, there's one thing; we don't have much competition in the movement of heavy tonnages. It simply has to be the Burlington.

We've gotten along all right on that with times of real friction, but we're surviving. But to tie both the coal that is Federal with the coal that is Burlington with the Burlington's monopoly on long haul heavy freight, seems to me to be too much control.

I'm not unique in that view among Montanans. I'm just speaking the preponderance of the vast majority of viewpoint of individual Montanans. So I would not like to see the provisions of 2(c) repealed.

I cannot think of any reason for modifying 2(c), since the language is very straightforward and easily understood, unless it was to skirt or circumvent the intent of 2(c). Therefore, I'm an advocate, a strong advocate representing Montana, to leave 2(c) exactly as it is.

As to the argument that perhaps 2(c) would open up more Federal leases, let me speak briefly on that. There's plenty of coal leased in general. The problem that we'll address, as you have outlined, Mr. Chairman, is what to do about those leases that have been held for the statutory time and perhaps have not amounted to anything in development. And what about the due diligence section of the law?

Well, we've got an overabundance of coal already leased, but that doesn't mean that there aren't some raw spots in different operation. The bypass provisions, the maintenance track provisions, as presented by the Department of the Interior, they may have a problem. The bypass of coal, that production would be lost if the leases were not made, is truly a serious problem. It can create a pattern of poor management.

As to maintenance tracts. Those operators that are now mining coal and they find themselves through the long, lengthy process of getting their mining plans approved or, first of all, developed and then approved, sometimes find themselves up against a blaze on how are they going to continue their operation without some shutdown and, therefore, very severe inconvenience. Sometimes a very harmful situation could develop for the workers at those particular mine sites.

To the extent that the Department of the Interior needs legislation in that regard, I think this committee should devote its time and energy to provide any necessary modifications of the law that hamper the Department of the Interior from allowing the bypass operations—to prevent the bypass operation from having to go into effect; allow the coal companies that are there to continue to operate and not bypass Federal coal; and also in regard to maintenance tracts, if the Department finds itself hampered by the constraints of the law, I think, we should review those carefully, work it out with them, and come out with the necessary legislation that is practical.

In conclusion, only let me state again, I see no reason for repealing 2(c) and, therefore, I probably see no reason for modifying 2(c). The competition is there. The chairman has mentioned that the coal market is soft, which indeed true, but modifying 2(c) to gain some unknown purpose is not in my judgment necessary legislation.

Senator **Wallop**. It does sound, though, from your remarks that you do recognize some circumstances under which, perhaps just reading between the lines, a case-by-case basis, you would think that as a matter of practical energy management, you would see that the Bureau of Land Management would be better off being able to develop some of those resources.

Senator **Melcher**. In regard to 2(c)?

Senator **Wallop**. Well, as I heard you say in terms of——

Senator **Melcher**. Bypass or maintenance.

Senator **Wallop**. Yes.

Senator **Melcher**. Bypass or maintenance are special cases. I think the ongoing operation of a mining venture should be allowed to continue without interruption and result in bypass; or, on the other hand, be closed down because a maintenance tract lease was issued quickly enough.

Senator **Wallop**. But that would either require special legislation or some modification of 2(c), would it not?

Senator **Melcher**. Are you referring to a subsidiary of a railroad?

Senator **Wallop**. Yes.

Senator **Melcher**. I've heard described by the Union Pacific of what they consider dire circumstance in the past. I think I've heard—I think it was in your State, Jeff—Santa Fe had a problem in regard to an operation they had or a subsidiary of theirs had? This was 2 or 3 years ago.

Senator **Bingaman**. Yes, they have a subsidiary, but, I think, they're going forward with some land trade to resolve the issue.

Senator **Melcher**. I have never heard of any compelling case whatsoever on behalf of the Burlington for them to get in the operation of coal on Federal land—or Federal coal. And I would review any particular case where bypass or maintenance is the issue, even if it were a subsidiary of a railroad.

But to open the door by removal of 2(c) I'd have to oppose. And if that would be the ploy in order to either modify 2(c) to where it was not effective or virtually repealed, I believe I'd have to oppose it.

Senator **Wallop**. Senator Hecht?

Senator **Hecht**. Nothing.

Senator **Wallop**. Jeff?

Senator **Bingaman**. I do not have questions, Mr. Chairman.

Senator **Wallop**. John, thank you very much.

I would announce at this time that several people are submitting statements to be inserted into this hearing record who were not able to be here today. They include Mobil Oil Corp., the Slurry Technology Association, Colorado Utility Co., and a statement from Gov. Richard Lamb of Colorada, the National Wildlife Federation, and Anaconda Minerals Co.[1]

Also, before calling him to the witness table, let me congratulate Steve Griles for his recent nomination to become Assistant Secretary for Land and Minerals Management at the Interior Department. It is my opinion and that of many others of us that Mr. Griles has been doing an admirable job as Acting Assistant Secretary, and I wish him well during the confirmation proceedings in front of this committee.

With that, Steve, we call you to the witness table under your hat as Deputy Assistant Secretary for Land and Minerals Management in the Department.

---

[1] The statements appear in appendix II.

STATEMENT OF J. STEVEN GRILES, DEPUTY ASSISTANT SECRETARY, LAND AND MINERALS MANAGEMENT, DEPARTMENT OF THE INTERIOR

Mr. GRILES. Mr. Chairman, thank you. I look forward to being before you again soon, I hope.

I appreciate the opportunity today to talk about the two issues of section 3 and section 7, as well as the issue of 2(c)—we've done this several times in the last few years and I welcome the statement you made, Mr. Chairman, that we need now to have action, because we agree with that.

I will not read my 25-page statement, realizing the time of the committee. I would like to summarize some key points and provisions of it, though, because I do think it's important that those here try to focus on what we do think of the real issues.

Senator WALLOP. We thank you for that. I was only half in jest yesterday, hoping the Potomac rose high enough to wash some of the debris that's up here away, too.

Mr. GRILES. Well, it would have been longer, but they closed the whole Government down early.

Mr. Chairman, your summary of the provisions of section 3 and its impact and the Bureau of Land Management study which we did transmit to you in September, are what we see being the real issue.

With the committee's permission, I would like to have entered into the record that analysis of which we've made sufficient copies for you today.[1]

Senator WALLOP. I would appreciate that. Thank you.

Mr. GRILES. That analysis, as you indicate, shows that the Mineral Leasing Act, as it's been operating, could be adversely and severely impacted if we do not address the August 1986 date. Those kinds of impacts, we think, are not in the public interest, were not what Congress had in mind when it enacted section 3 in 1976, and in fact will have a detrimental impact not only on the Mineral Leasing Act, but also on those who benefit from the Mineral Leasing Act; specifically the States, the amount of revenues the States receive, as well as the opportunity to assure competition both in the coal market, but also in the oil and gas leasing onshore program and other leasing minerals under the Mineral Leasing Act, all of which we think are undesirable.

In regards to where we move from here, we think, Mr. Chairman, that section 3 and section 7, as you've indicated, that conceptually the two sections involve the same policy; the same policy, meaning they were designed for diligence purposes and for anti-speculation. They're two different provisions and their timing is different but their impacts are similar.

What they do, we believe, is create an artificial timeframe for production of coal into a marketplace that may not be ready for it when tremendous capital investment has been made. The average mine—and the three witnesses who follow can speak more to the costs of the capital investment—the numbers I've been told range from $250 million and higher.

---

[1] The document has been retained in subcommittee files.

We are proposing that the market would not be allowed to work in a proper manner because of legislation that was enacted in 1976. What the Department proposes in this study and what we've recommended to the committee—and recommend—is that conceptually, in lieu of section 3 and in lieu of section 7, that the committee enact a minimum royalty payment which would go forward, and each year the lessors who hold the leases that are in noncompliance with section 3 and section 7 would be required to pay a minimum royalty.

In the report and in that testimony, we talk about how that would be calculated. We believe that that provision will be market-based and not oriented toward some artificial Government policy that does not in fact recognize that the market can, does, and must be the mechanism that we recognize.

Credited against future production. We mean by that, that instead of having a penalty, that a clause should be inserted into the law that says if you hold the lease, that you must pay so much to hold that lease. One of the provisions of several of the bills that have been introduced here on the Senate side, as well as on the House side, does not allow that fee to be credited toward future production. We do not think that's wise public policy, and I'd like to take a minute and explain why.

We believe that there should be an incentive for production, not a disincentive for production. We believe that the fee should be high enough so that the company management will make a decision that they have an expectation to put that lease into production at a future date. And if they move in that regard toward mine development, mine plan submittal and all the factors, it can obviously take longer than the 10 years that we now have for that to occur, for production to begin.

The disincentive of a penalty which I believe a noncredited royalty would be is that they can walk away from it. There is no incentive to put it in production. By allowing the fees to be credited toward future production, it is an incentive to get to production. And for that reason; one, we believe that the fee itself should be credited; two, it will result in an enhancement toward production; and it will also address the other issue, that issue of antispeculation. By making the fee higher, you can in fact make that antispeculation provision obviously have more of an impact than, say, a penalty provision of 1 cent a ton.

Another thing about a holding fee which some have proposed, the holding fee, we think, should be based on value of coal, not on some artificial 1 cent a ton or 2 cents a ton. I can give you a good example of why we think that is wrong.

Fort Union Coal in North Dakota—the value of that coal versus Powder River coal, versus the coal in New Mexico or Colorado is all different. It's different Btu. It's a different market. It's a different transportation cost and a different mining cost. And to impose the same fee on all of those kinds of regions is not appropriate. It could impose a different financial burden upon a company; whereas if you make it market-based, value-based, we think that it will in fact have a uniform application throughout the coal regions.

For that reason, we think it should be a value-based creditable fee.

I think, Mr. Chairman, that basically tells where we are on the concept. One of the specific provisions that your bill and others have proposed is the elimination of the 40-year timeframe for leases. We believe that the 40-year mine-out provisions are in fact not realistic, will not in fact allow for the market to work in an appropriate manner.

We believe that by having a logical mining units form and letting the mine get into production, the companies then will be under the provisions we're talking about, paying royalties, advance royalties if they're not producing; it will have to make a financial management decision about how long and what the market conditions are.

A 40-year mine-out forces the companies either to leave the coal in the ground, to come in violation of the provision, or produce coal into a market which it may not be ready to do; driving the price of coal down, artificially, and impacting on States which are dependent on some of these revenues; not a desirable consequence.

We think that by having enough coal available to compete at the contract stage, having enough competitors in the marketplace will in fact assure such a price is reflective of the market and not through some artificial 40-year mine-out.

I think there are a number of other provisions of section 3 that we address in our testimony and I will not take much time with that. One issue that has been suggested by some and introduced by Congress and discussed is the turnback provision. That's the term that has been used.

That provision will allow companies to turn back certain leases if they acquire additional leases. Mr. Chairman, we in our study and in our testimony, have indicated that we do not believe that that's an appropriate way to deal with the market mechanism.

One fact I think is quite relevant, though. These leases were acquired prior to 1976, acquired prior to section 3, section 7, and to penalize some of the major coal companies in terms of the bypass issue, the maintenance tract, is not an appropriate management of a resource. So we think you need to look at that issue because for a company which has only one noncomplying lease and for some who have a great number under a holding fee, the economic impact could be quite different for the two different companies and may make the ability to compete in the marketplace quite different.

We'd like to work with the committee and the staff in terms of that issue.

In terms of the lease readjustments, I was asked by Senator Johnston to speak to that at this hearing, and if I could, I will for a moment. You have other witnesses who will testify today about the unit proper leased readjustments. Senator Johnston received a letter from Western Resource Councils, the Sierra Club, and the Friends of the Earth, dated the 4th of November. I was handed a copy of that letter today.

I would like to just indicate several things, Mr. Chairman. First of all, I commend those groups for recognizing that the errors of the previous administration are theirs and not ours. The lease readjustments are a problem. We found that in 1983 when we began to recognize that the lessors had not been properly notified. We set up a management strategy, management system, and notification system that is in place. And I am happy to report to the committee, since that time to my knowledge—and I've been informed by BLM that we have had proper notification and the leases are being notified and adjusted properly.

There are some other issues that are outstanding that we are dealing with. Are the leases being readjusted on a 10-year term and and a 20-year term? All of the issues are laid out in the letter that Senator Johnston sent to me. Rather than going into the details of what is very much a legal issue, because the tenth circuit has ruled on this issue, as well as IBLA and other judges, I'd like to submit for the record, at Senator Johnston's request, a detailed analysis of the letter that we received.[1]

I have to admit that the conservation groups that wrote this letter in fact did not have all the information and we would like to sit down with them and go through what the facts are so that they will have a better understanding.

I think the bottom line is, the majority of the leases, more than a majority, are being properly managed today. We believe we have a process in place that will prevent any future leases from not being readjusted in a timely manner.

With that, I would like to move on to the other issue real quickly, and that's 2(c). I asked the staff to pull for me, Mr. Chairman, a little bit of the legislative history. In 1957, 1962, 1966, 1975, 1981, and 1983 the Department of the Interior has appeared before the committee and said they believed that 2(c) needed to be repealed and addressed.

We're here today to say that we think that 2(c) should be amended. The administration has fought for repeal in the past. We believe that in order to make the issue—I want to say go away or to be properly managed—that it does need to be amended.

Senator Melcher made a good point. We have coal being mined today on private sections, State sections, by railroad affiliates with Federal coal that is going to be bypassed and will never be mined, and lost as a public resource. I do not think that's a proper way for the public's resource to be managed.

Second, in lieu of repeal, the administration recommends that the committee adopt a cooperative leasing approach. Conceptually, this allows for the market to work. It allows for the railroad section and Federal sections to be put up as a unit and to be bid on by all of those in the marketplace, uniformly—the highest bidder gets the tract.

The Federal Government would establish the value of that mine unit. No one would have the proprietary data. All companies, individuals, would have the same geological information, and therefore the market would work. We believe that that allows for logical mining of the coal; it allows for the coal which would be bypassed to be mined. Some have said we just need to recognize and allow these companies to have the authority to lease bypass and maintenance coal.

For those who are aware of how these sections are divided, what we are simply setting ourselves up for is continuous [always] bypass and maintenance to these companies. That's not the proper way for the public to get the right return and the proper way to be sure competition occurs in the marketplace for the Federal coal.

---

[1] The letter appears following Mr. Griles prepared statement.

We think this approach which is new to the administration's position will in fact go a long ways to addressing the concerns that Senator Melcher has, concerns that others on the committee have. We hope that it will address both our friends in the railroad as well as in the coal industry. We believe that we're working with some of the proposals we have. That is, by making price information available on contracts, not publicly, but to the ICC and letting the ICC manage some of these issues, we think that unfair competition or the use that some fear, that the railroads could in fact have their coal affiliate charge less for their shipping rates, and therefore more for their coal—or less for their coal, more for their shipping rates—and therefore the Federal Government would get less royalty can be dealt with.

It does take some time to address those issues.

In closing, Mr. Chairman, two requests. We believe, as you do, that section 3 and section 7 need to be addressed now. We need to get on with coming up with a logical future for the Federal Coal Leasing Program and implementation of the Mineral Leasing Act. Its impact is broad. It could have a dramatic impact on some of the Western States.

Second, as a relationship to 2(c), we believe the provision needs to be addressed. We are willing to work with all parties to address that issue.

With that, Mr. Chairman, I will respond to questions.

[The prepared statement of Mr. Griles and letter previously mentioned follow:]

NOV 8 1985

STATEMENT OF J. STEVEN GRILES, DEPUTY ASSISTANT SECRETARY, LAND AND MINERALS MANAGEMENT, UNITED STATES DEPARTMENT OF THE INTERIOR, BEFORE THE SUBCOMMITTEE ON NATURAL RESOURCES DEVELOPMENT AND PRODUCTION, COMMITTEE ON ENERGY AND NATURAL RESOURCES, UNITED STATES SENATE, ON S. 372, A BILL "TO AMEND THE MINERAL LANDS LEASING ACT OF 1920, AND FOR OTHER PURPOSES", S. 570, A BILL "TO AMEND THE MINERAL LANDS LEASING ACT OF 1920 TO IMPROVE THE ADMINISTRATION OF THE FEDERAL COAL LEASING PROGRAM, AND FOR OTHER PURPOSES", S. 913, A BILL "TO AMEND THE MINERAL LANDS LEASING ACT OF 1920 TO IMPROVE THE ADMINISTRATION OF THE FEDERAL COAL LEASING PROGRAM, AND FOR OTHER PURPOSES", AND S. 946, A BILL "TO AMEND THE FEDERAL COAL LEASING AMENDMENTS ACT OF 1976, AND FOR OTHER PURPOSES".

Thank you for the opportunity to present the Department of the Interior's views on the four bills that are the subject of this hearing, S. 372, S. 570, S. 913 and S. 946. The bills would amend several provisions of the Mineral Lands Leasing Act relating specifically to coal.

This Administration, recognizing the Nation's vital need for energy self-sufficiency, places a high priority on the orderly development and use of our country's vast coal resource. The Department of the Interior has responded to the mandate of the Mineral Leasing Act of 1920 and the Federal Coal Leasing Amendments Act in establishing our coal leasing program. This program is designed to promote the use of coal within a balanced structure. However, we agree with the sponsors of S. 372, S. 570, and S. 913 that some of the provisions of the Mineral Leasing Act of 1920, as amended by the Federal Coal Leasing Amendments Act, do not allow either the Department or industry sufficient flexibility to accommodate realistic coal development timeframes.

Among the provisions of the 1976 amendments is section 3 of the Federal Coal Leasing Amendments Act, which provides that the holder of a Federal coal lease who has held that lease for 10 years and is not producing in commercial quantities, cannot after August 4, 1986, obtain any leases under the Mineral Leasing Act of 1920. This part of section 3 of the Federal Coal Leasing Amendments Act became section 2(a)(2)(A) of the Mineral Leasing Act of 1920. However, I will refer to it as section 3 or the anti-speculation provision. In addition, section 6 of the Federal Coal Leasing Amendments Act modified section 7 of the Mineral Lands Leasing Act to require the Secretary to terminate any post-1976 lease, whether issued or readjusted after 1976, that is not in commercial production 10 years after its issuance or readjustment. I shall refer to this section as section 7 or the diligence provision. I need not remind anyone here of the interest this provision of the 1976 statute has generated, as these 10-year periods run down, among those energy firms holding Federal coal leases, as well as among the environmental community.

I will first summarize the Department's views on the need for amending sections 3 and 7; I will then provide the Department's views on the specific legislative proposals -- S. 372, S. 570, S. 913, and S. 946 -- currently under consideration by this subcommittee.

To assess the impacts of sections 3 and 7, I directed the Office of Minerals Policy Analysis, within the Bureau of Land Management, to prepare an analysis and assess the implications of the current legislation as well as to review and evaluate certain options for amending that legislation. Its study, entitled "Analysis Of Options For Amending the Mineral Leasing Act Sections 2(a)2(A) and 7", was formally transmitted to you on September 17, 1985. With the Subcommittee's permission, I ask that the study be entered into the record. In the study, the analysis of alternatives focuses on an examination of the propriety of using a minimum royalty payment, sometimes referred to as a holding fee, as an incentive to encourage diligent development and discourage unproductive speculative holding of undeveloped leases. This analysis has undergone review and approval in the Administration.

Our study strongly suggests that enforcement of the present provisions of section 3 and 7 will have profound adverse repercussions on our minerals programs.

From our analysis, we identified 224 leases containing about 5.2 billion tons of coal reserves that are not likely to be in compliance with section 3 on August 4, 1986. About 104 of these leases are held by firms with oil and gas interests and roughly 35 each are held by electric utilities, coal producers with no oil and gas interests, and other miscellaneous industry groups. Another 15 of these leases are held by steel companies.

The States with the most leases that we expect to be in a noncompliance status on August 4, 1986, are Utah with 84 leases, Wyoming with 31, and Colorado with 42 leases.

Last of all, enforcement of section 3 would generate ripple effects. In the extreme case, 300 coal mining companies and 150 oil and gas companies when all their affiliates are counted, may be prevented form obtaining leases under the Mineral Lands Leasing Act of 1920 after August 4, 1986, if section 3 is not amended or repealed.

I hasten to add that these figures must be viewed as "most likely" estimates from a wide range of possible outcomes. They are based on numerous assumptions regarding industry actions that have not yet taken place, such as LMU filings and production restarts.

Our analysis indicates that enforcement of these provisions would be contrary to the Federal interest, contrary to congressional policy, and disruptive to efficient program operations.

Specifically, enforcement of section 3 will likely have a number of detrimental results:

- o A decision by lessees against relinquishing or assigning noncomplying leases will mean a reduction in the number of firms that may compete for Federal mineral leases under the Mineral Lands Leasing Act of 1920.

- o Reduced competition for leases, the potential requirement to accept bids that are less than the bid that might have been offered if more eligible bidders could participate for a tract, and the relinquishment of leases that might otherwise in the late 1980's have generated royalties to the Federal government, would reduce total lease revenue payments to the government, thereby decreasing redistribution to the States and increasing the Federal deficit.

- If substantial numbers of noncomplying leases are relinquished, this may lead to the unanticipated need to lease additional coal resources to meet the Nation's energy requirements.
- Holders of noncomplying leases may be encouraged simply to swap ownership of their leases with other lessees to start new 10-year holding periods and thus avoid the prohibition on acquiring additional Federal mineral leases under the Mineral Lands Leasing Act of 1920.
- Lessees will be prevented from developing some leases at the time at which the leases would have maximum value to the lessee or the nation.
- Enforcement of the section 3 limitation will impose a significant administrative burden on BLM.

Enforcement of section 7 is expected to have similar undesirable effects. Specifically:

- Lease revenues and lease competition may be reduced as prospective lessees discount or refuse to submit bids for leases because of the possibility that they will not be able to sell and develop coal efficiently within the permitted time.

- Just as for section 3, lessees will be prevented from developing some leases at the time at which the leases would have maximum value to the lessee or the nation.

- The 10-year time limit for lease development will effectively kill the assignments market, which can assist in ensuring that leases are allocated to their highest valued use.

Although the problems caused by sections 3 and 7 will occur at different times and will affect different leases, conceptually the two sections involve the same policy issue, namely the design of a diligence/anti-speculation policy. Because it is a single issue, it is possible and indeed important to provide a single, consistent solution. Accordingly, we believe Congress, in addressing sections 3 and 7, should consider a single approach to the development of a diligence/anti-speculation policy.

As the result of the analyses undertaken by the Department and our consideration of the alternative approaches to amending sections 3 and 7, we recommend that Congress amend sections 3 and 7, replacing their diligence/anti-speculation provisions with a minimum royalty payment in lieu of lessee disqualification and lease termination. This approach is consistent with a recommendation of the Linowes Commission as well as previous statements made by this Administration.

The specific elements of our recommendation include amending section 3 so that the prohibition on acquisition of new leases would apply only to new coal leases, not to all mineral leases. In addition, the prohibition would be applied only to the lessees and the consolidated subsidiaries of the parent corporation, as interpreted by the Internal Revenue Service.

The bills addressing a holding fee generally suggest the application of the fee to newly acquired leases. We recommend a broader application. That is, the addition of an optional holding fee that current lessees may elect to pay on their otherwise non-complying leases.

The Department recommends that the holding fee be defined as a minimum royalty payment in lieu of production, related to the market value of similar produced coal in the region (value based), and creditable against royalties later due on production in excess of the minimum amount on which the holding fee is calculated. That is, during the years when coal is produced and the previously paid holding fees are credited, the royalty payment would be required to be at least equal to the holding fee assessed in years of non-production. It is further recommended that the holding fee be automatically applicable to all new and readjusted leases, and be available as an election, by the lessee, on pre-1976 leases prior to readjustment. With respect to section 7, the lessees should have the option of either remaining subject to the risk of termination of the lease at the end of the specified period of 10 years in section 7, or electing to pay the holding fee. This would ensure that a lease near production is not arbitrarily cancelled.

To insure that the holding fee can be recognized as an expense in the year paid for tax purposes, the basis of the holding fee should be defined as a fixed percentage of recoverable reserves by coal region. On the basis of its current analysis, the Department judges that a 0.3 percent annual rate would be an appropriate level of production on which to base the minimum royalty payment. Further, the Department believes that the production level on which the fee would be assessed is best determined by the Secretary at the time of implementation. However, if Congress should decide to establish the production level by law, then the Department recommends that it not be higher than a 0.3 percent annual production rate. The minimum royalty would then be obtained by multiplying this rate by the recoverable reserves and the current market price for that quality coal in the particular region.

Our analyses further suggest that the ten-year development timeframe before application of the minimum royalty requirement may be too short to permit compliance with diligent production standards. The time needed to enter a coal sales contract, obtain needed permits for opening a mine, and develop and bring a mine into production suggests that a 12 to 15-year diligence period may be more realistic. Consequently, we recommend that Congress extend the diligence period as we suggest.

In addition, we recommend that there be no limit on the number of years that a lessee could make minimum royalty payments in lieu of production. The reason for this recommendation is to prevent the sort of artificial time constraint and subsequent problems that the current provisions of section 3 and 7 have caused. In any event, our analyses show that with minimum royalties at the .3 percent rate it is highly unlikely that a lessee would make payments for as long a period as 10 years after beginning payments, because the lessee would no longer be in an adequate profit position, prior to beginning production or relinquishing a tract.

An important advantage of implementing a value-based fee (related to the current selling price of coal) is that it should relieve the need for the Secretary to make frequent adjustments to the level of a holding fee as a result of changes in market conditions, since variations in market price will be automatically reflected. Indeed, a change in the fee level would be warranted only if major structural changes occurred in coal markets. Thus, it is not currently foreseen that the Secretary would need to adjust the fee basis in future years. If, in the unlikely circumstance that it became necessary to adjust the fee basis, you can be assured that the Secretary would prepare a detailed analysis of, and the rationale for, the determinations regarding specific terms and levels of fees.

This concludes my discussion of the Department's recommendations regarding the amendment of the diligence and anti-speculation provisions of sections 3 and 7. I will now turn to the specific bills S. 372, S. 570, S. 913 and S. 946, which are currently under consideration by this subcommittee. Because several features of the legislation are common to more than one proposal, I have organized my discussion to address similar provisions in all of the bills rather than dealing with each bill separately.

With regard to the section 3 prohibition of the acquisition of additional mineral leases under the Mineral Lands Leasing Act of 1920, S. 372 provides that this prohibition would not apply:

(1) where an entity agrees to relinquish a noncomplying coal lease or leases containing estimated recoverable coal reserves equivalent to the estimated recoverable reserves from the lease or leases being issued;

(2) where an entity holds noncomplying leases issued prior to August 4, 1976, and pays an additional annual rental or holding fee on those coal deposits being acquired; and

(3) where the Secretary accepts the relinquishment by the lessee of any coal lease issued prior to August 4, 1976, where there has not been significant surface disturbance.

S. 570 would simply delete section 3. S. 913 would restrict application of the leasing prohibition only to coal leases.

As I have already discussed, the Department favors restricting the prohibition provisions of section 3 to the acquisition of new coal leases only. However, we do not recommend amending the prohibition to allow the relinquishment of noncomplying leases (or reserves) in return for the privilege of receiving new leases. As is discussed in the analytic report (at pages 54 through 56) I referred to earlier, such a provision would cause distortions in the coal lease market and, may cause lessees to hold or acquire (from other lessees) lower valued leases simply for the purpose of relinquishment to obtain new leases. In addition, if a holding fee is to be substituted for the current diligence/anti-speculation provisions, then we recommend that it be applied to any lease that has been held longer than the permitted diligence period and not applied only when a lessee obtains additional leases (while holding noncomplying leases).

Both S. 372 and S. 570 would amend section 7 of the Mineral Lands Leasing Act of 1920 to provide that a coal lease shall be for a term of 20 years and for so long thereafter as the condition of continued operation is met. Such language ends the incongruity in current law in which the payment of advance royalties in lieu of continued operation does not clearly extend the lease, as production in commercial quantities annually is now required to extend the lease beyond the 20th year. We support such a provision.

Section 3 of S. 372 would amend section 7(a) of the Mineral Lands Leasing Act of 1920 to provide that readjustment of "old" leases to the new royalty rates (12 1/2 percent for surface coal and 8 percent for underground coal) will occur by operation of law on their next anniversary date. The relevance of this provision has been brought to your and Senator Johnston's attention by the letter of November 4, 1985, from the Western Organization of Resource Councils, Sierra Club and Friends of the Earth to Secretary Hodel. While we believe we have the process of readjusting "old" coal leases under control, and no lease readjustments are being waived as anniversary dates come up, we do not oppose having this occur by operation of law, without the need for BLM action and the delay and uncertainty of lessees' protests and appeals of these BLM actions.

Both S. 372 and S. 570 also would provide that a lease not producing coal in commercial quantities at the end of 10 years after lease issuance or readjustment after August 4, 1986, would be terminated unless the lessee chooses to extend the lease beyond the 10th lease year through payment of advance royalties in lieu of diligent development. The advance royalties would be assessed on an escalating basis.

While we support the use of a fee as I have stated earlier, we do not agree with the concept of escalating advance royalties as provided for in S. 372 and S. 570. Specifically, in view of current and foreseeable market conditions, escalation is not needed to achieve the diligence incentive effects we desire and may simply cause lessees to relinquish leases rather than making rational economic decisions concerning the near-term likelihood of the lease being developed. Moreover, the inclusion of crediting for minimum royalties, as we have recommended, will provide an escalating incentive to produce leases without imposing the escalating financial burden that would result from the escalating fee. As we said earlier, it is highly unlikely that a lessee would make payments for a lengthy period prior to beginning production or relinquishing a tract. Also, as discussed earlier, there is uncertainty as to the tax treatment of the advance royalties if they are collected on an escalating, instead of a constant, basis. We would like to avoid the adverse effects resulting from this uncertainty by suggesting a constant rate in lieu of the escalating rate. Finally, enforcement of the escalation provision would be an extreme administrative burden.

Both S. 372 and S. 570 would provide for crediting of the previously paid advance royalties against the actual production royalties that would be subsequently due from the producing lease. We support this provision. However, S. 372 provides for no minimum cash royalty payment during production while S. 570 would provide for a minimum payment. We support the inclusion of a minimum payment provision as it will stabilize the lease revenue stream to States. We recommend that the minimum payment be based on the same production level as that used in computing the minimum or advance royalty to be applied to noncomplying leases.

Also, both S. 372 and S. 570 would direct the Secretary to promulgate rules and regulations to provide for experimentation with the negotiated sale of leases for bypass and maintenance tracts. Such provision would allow the Secretary the necessary flexibility to address this problem.

Section 5 of S. 372 would also prohibit any officer, employee, contractor or agent of the Department from disclosing to anyone not an employee, contractor or agent of the Department any data developed by the Department for estimating coal tract value. While we support the concept of treating such data confidentially, we believe that the provisions should be limited to prohibiting public disclosure of the data. We also believe that the type of data intended to be covered should be described in more detail. For example, the pre-sale appraisal value and the identification of specific comparables, if any, should be confidential. Other factors, such as tonnage, BTU's, stripping ratio, discount rates, expected prices, etc., in most cases, should not have a confidential classification. We will work with Subcommittee staff in developing specific language.

Section 6 of S. 372 also would direct the Comptroller General to monitor the coal program for 5 years and submit semiannual reports to the Congress. We believe this requirement is redundant. Safeguards are already in place to assure that the new coal program will be carefully monitored, and any additional review would be duplicative. The Department's Inspector General will conduct periodic audits of the coal program as indicated by the Secretary in his response to Congress on March 19, 1984, regarding the Linowes

Commission's recommendations. Further, the Department will work toward integrating program oversight functions into internal program management under OMB Directive A-123 and the Federal Manager's Financial Integrity Act.

Section 7 of S. 372 would amend section 30 of the Mineral Lands Leasing Act of 1920 to direct the Secretary to promulgate regulations which would require that, prior to his approval of any transfer of a record title interest or assignment of operating rights in a lease, the transferor submit a financial document describing the value paid or promised for the transfer. The regulations would set forth the type of information required to be filed. While we do not believe legislation is necessary, we do not have an objection.

Section 3 of S. 570 would eliminate the requirement that all lands in a logical mining unit shall be contiguous. We support the repeal of this requirement. The contiguity requirement ignores the geological, geographical and engineering realities of coal deposits and is inconsistent with the purpose of logical mining unit planning -- that the lands will be mined as a single unit by a single operator.

We believe that the matter of combining tracts separated by barriers such as rights-of-way and the like has been handled by the 1982 operating regulations defining contiguity in terms of legal subdivisions. There is no compelling reason to keep the requirement in the law. Accordingly, the Department believes it is appropriate to delete this statutory provision.

Section 5 of S. 570 would delete the requirement in the present law that all reserves in the entire logical mining unit shall be mined within 40 years. We agree that the 40-year requirement should be deleted. The incentive to form a logical mining unit is seriously compromised by the present requirement. A lessee contemplating forming a logical mining unit faces the problem that a 40-year mineout may limit the size of the LMU or demand an unreasonable production rate which would be inconsistent with the most efficient mining practice. The current provision will not only negatively impact State revenues, but create an artificiality in the definition of an LMU, inconsistent with the notion that an LMU should be an administrative reflection, for diligence purposes, of a reasonable mining plan.

Furthermore, the 40-year requirement does not on its face take into account the years under current law in which advance royalties may be paid in lieu of continued operation of the leases in a logical mining unit; that is, a lessee who pays advance royalties for 10 years after initiating production is faced with a maximum of a 30-year mineout requirement.

Both S. 372 and S. 570 remove the requirement for submittal of a resource recovery and protection plan within 3 years. We agree with this provision. This is a redundance of the requirement that a more detailed plan is required at the time of permit approval.

S. 946 would amend section 2(a) of the Mineral Lands Leasing Act of 1920, as amended by section 3 of the Federal Coal Leasing Amendments Act of 1976 by adding a provision directing the Secretary of the Interior not to issue a competitive coal lease to an entity that is affiliated with an entity engaged in the extraction or production of coal reserves in a foreign country and the importation of such reserves into the United States. Such a measure would run counter to the interests of consumers by not allowing fair competition to set price levels. Instead, S. 946 would legislate constraints which would impede the competitive process and violate our international trade obligations. We are also concerned that the proposal could have significant effects on a number of the policy objectives of our Federal coal leasing program. Accordingly, the Administration opposes S. 946.

I will now address two proposed amendments to S. 570 numbered 801 and 802. Amendment 802 would simply repeal section 2(c) of the Mineral Lands Leasing Act, while amendment 801 would amend section 2(c) to allow a common carrier railroad company to hold Federal leases of coal deposits subject to certain specified conditions.

I would like to take this opportunity to express my pleasure and congratulate those interests affected by section 2(c) in their attempt to address this Federal-private, splits and divisions issue. It is my hope that the Committee will resolve this issue in an expeditious manner inasmuch as August 1986 is only 10 months away.

We have determined that modification of section 2(c), rather than outright repeal, is the preferred approach and is consistent with the conclusions of the Linowes Commission. Specifically, we believe that cooperative leasing should be the only method of leasing by railroads in checkerboard areas.

There are three relevant, potentially conflicting policy objectives to be considered when leasing to railroad companies: (1) the recognition of the need for timely and orderly development of coal resources; (2) the consolidation of the checkerboard lands into units that can be mined in an efficient and logical manner; and (3) the promotion of competition. To the extent that some coal within a checkerboard area is more economically ready for development than some coal outside the checkerboard areas, achieving the objective of orderly development would be enhanced by leasing checkerboard coal. Promotion of competition is a far more complicated question. Allowing the railroads to compete for Federal leases would enhance competition. However, to the extent that the railroads may be in a position to exert monopoly power, the objective of promoting competition could be impeded by allowing railroad related entities to acquire coal leases. Although the proposed amendment addresses a number of these issues, we believe it should be amended before the Administration could support its enactment.

We believe that efforts must be made to prevent railroads from being able to exercise potential monopoly power once they are allowed to acquire Federal coal leases. The Department of Justice will, when consulted by the Secretary of the Interior prior to each issuance, readjustment, or renewal of a Federal coal lease, continue to review and advise the Secretary whether the transaction would create or maintain a situation inconsistent with the antitrust laws, as provided under section 15 of the Federal Coal Leasing Amendments Act. If these safeguards prove inadequate, other legislative safeguards may be needed. We have several safeguards in mind and are currently studying them to ascertain if they will be necessary to assure sufficient protection against the potential abuse of monopoly power.

The primary safeguard under Departmental review would prohibit a railroad from bidding on any tract in an area where the rail carrier has market power over the transportation of coal, unless certain conditions are met. However, such railroads would be free to compete without any restrictions on any tracts outside the area they service.

With respect to the Federal coal lands in a checkerboard area, we support the requirement for cooperative leasing when a railroad wants to lease tracts within these areas, as recommended by the Linowes Commission. The objective of cooperative leasing is to combine all rights before the lease sale so bidders know in advance the terms and conditions to apply to the entire tract for acquiring both the Federal and non-Federal rights. Railroads would also be required to make available to all potential bidders all information on the coal characteristics and other features of the railroad portion of the mining unit. Prior to a lease offering, the Secretary, in consultation with the railroad owner, would determine which Federal and railroad tracts within a checkerboard area would constitute the most competitively attractive offering. The Secretary would negotiate the percentage share of the mining unit to be the Federal share. The entire package would be offered as a single lease and the United States would receive the agreed upon share of the total bonus paid as well as that same percentage share of future royalties due. Another benefit of cooperative leasing is that the entire package may well bring more at auction than the sum of the individual parts.

I will now address the specific language in amendment number 801.

Section (2)(A) addresses two of the conditions I have mentioned -- the requirement for cooperative leasing and the availability of data. The proposed amendment would require the railroad or affiliated company to notify the Secretary of its desire to compete for a Federal lease to be offered in the checkerboard. Upon notification, the Secretary would make an explicit finding as to whether competition for the Federal lease would be substantially enhanced. If the Secretary finds such enhancement, the Secretary would:

o identify a potential mining unit containing the Federal tract as well as tracts owned by the railroad;

o require the railroad, as a precondition for bidding on the Federal tract, to agree to make available at cost to any potential bidder, any and all exploration data in the railroad's possession concerning the extent and nature of the land-grant coal deposits; and

- require the railroad, as a further precondition for bidding, to agree to offer for lease to the winner of the Federal tract if not the railroad, the land-grant coal deposits on terms mutually agreed to by the Secretary and the railroad.

We believe that mandatory cooperative leasing should be the condition for all railroad leasing in its own checkerboard area. We are unable to identify any situation in which allowing railroads to compete in a checkerboard area could or should not be subject to cooperative leasing. Therefore it is neither necessary nor appropriate to require the Secretary to make an explicit finding of enhanced competition before allowing railroad participation in a cooperative leasing agreement.

Instead of following the cooperative leasing procedures required by the proposed amendment, we favor advance negotiation of bid and royalty shares to reduce uncertainty. This is also important because the entire lease package may bring more revenue than the sum of its parts. Moreover, advance negotiation of shares is consistent with unitization in oil and gas leasing.

We agree with the objectives of the bidding data disclosure provision of the proposed amendment. However, we recommend that legislation also provide guidance as to what would constitute a reasonable cost to any potential bidder interested in acquiring exploration data. Further, we believe all potential bidders for the lease package should be able to obtain the necessary geological data directly from the jointly held mining unit, as an option, rather than purchasing such information from the railroad.

Paragraph (B) of section 2 provides for four exceptions or situations in which the railroad or its affiliate may bid on a Federal lease without conditions. Those exceptions would occur when:

- the Secretary does not make a finding of significant competition enhancement;
- the railroad-affiliated company has a less than 30 percent interest in the joint venture which would own or control the Federal lease;
- the Federal coal constitutes less than 35 percent of the reserves the lessee will need to develop and cooperate its mine (when the government is a minority coal owner); or
- the railroad-affiliated company is already operating a mine on the adjacent property and the Federal coal either is already in or adjacent to the mine's permit area or will be bypassed or is needed to maintain the mine (similar to bypass and maintenance leasing exceptions in the present leasing program).

We do not support these exceptions. Again, we are unable to identify any situation in which allowing railroads to compete in a checkerboard area could or should not be subject to cooperative leasing. Therefore, there is no purpose in the requirement of a Secretarial finding concerning significant competition enhancement.

Second, we believe that allowing a railroad to hold a minority position in a Federal tract in a checkerboard area could also permit the same railroad to hold a controlling interest in any mining unit containing that tract.

Third, although we understand the rationale for the bypass exception of section (2)(B), we oppose this provision. In its present form, due to the checkerboard pattern, the bypass exception may permit a railroad to initiate mining in such a manner as to surround a Federal tract, thus creating a maintenance or bypass situation. This would constitute an undesirable disincentive to cooperative leasing.

Amendment 801 would also provide for disclosure of transportation contracts and bids by the railroads to the Secretary; and for the Secretary to disclose these contracts under certain conditions.

We have three concerns with this requirement: First, the Department of the Interior lacks expertise in reviewing the terms and conditions of transportation contracts. Second, this requirement may duplicate efforts currently performed by the Interstate Commerce Commission (ICC). Third, the requirement for public disclosure is inappropriate and could lead to anti-competitive pricing. Accordingly, we oppose this requirement.

The problem this section attempts to address is that of the railroads' artificially charging their affiliates less than non-affiliates. If such price differences are not based on differences in the cost of providing service, then the practice may grant the railroads' affiliates an unfair competitive advantage.

However, there is another problem that the amendment fails to recognize -- that is, that the railroad may charge its affiliate more, requiring its affiliate to lower its mine-mouth price, which could have the same undesirable effects on competition. Moreover, it introduces the additional problem of denying the Federal Government its proper royalties. This problem comes from the options available to a vertically integrated entity in conducting its business.

I pledge our full cooperation in working with members of this Subcommittee on matters relating to coal leasing.

Thank you for the opportunity to appear before the Subcommittee. I will be pleased to respond to any questions you may have.

3451 (660)

NOV 25 1985

Honorable J. Bennett Johnston
United States Senate
Washington, D.C. 20510

Dear Senator Johnston:

Thank you for your November 5, 1985, letter to Secretary Hodel requesting that we review the issues addressed in a November 4, 1985, letter to the Secretary from the Western Organization of Resource Councils, the Sierra Club, and Friends of the Earth (hereinafter referred to as "organizations"). The Secretary has requested that we respond to you directly.

We appreciate your interest in the issue of Federal coal lease readjustments and in the progress on legislation relating to the Federal Coal Management Program. As to the past history of Federal coal lease readjustments, it is commendable that the organizations have expended substantial time and effort to study the readjustment process based on the data furnished by the Bureau of Land Management (BLM). We are in full agreement with one of the organizations' primary conclusions, stated at two places in their letter, which clearly identifies this matter as being a complex web of deficiencies resulting from the practices of the previous Administration.

The BLM staff and officials began an in-depth review of the readjustment process and associated leases approximately 2 years ago. We completed our analysis in July 1984. As a result of our internal review, we restructured the Federal coal lease readjustment process. On July 6, 1984, the BLM State Directors were instructed (copy enclosed) to take specific actions in order to ensure that all Federal coal leases are timely readjusted. On December 7, 1984, the State Directors were further instructed (copy enclosed) to report quarterly on the status of readjustments. The quarterly reports are analyzed to ensure conformance with the established readjustment procedures and to identify and correct potential readjustment problems before they occur. Now that our automated Solid Leasable Minerals System (SLMS) is operational, we will also use automated data processing techniques to monitor Federal coal lease readjustments closely. The SLMS was designed to enhance our administration of all coal and solid leasable minerals on Federal and Indian lands. We have also established a chain of accountability for the quarterly reporting requirement in the Secretarial Management by Objective process.

With our identification and correction of readjustment procedural deficiencies, we are confident that our continuing attention to readjustments will ensure that the problems of the past are corrected. Our detailed responses to the concerns expressed in the November 4, 1985, letter follow.

At the outset, it should be noted that the organizations' assertions that BLM has readjusted Federal coal leases without subjecting them to the Federal Coal Leasing Amendments Act of 1976 (FCLAA) 12 1/2 percent royalty rate for surface-mined coal and the 10-year diligence requirement are not accurate. This statement reflects certain misunderstandings that will be clarified below.

As background, readjustments are made in accordance with the Mineral Leasing Act of 1920 (MLA) and FCLAA. The MLA, prior to amendment by FCLAA, provided that Federal coal leases shall be for indeterminate periods and that, at the end of each 20-year period succeeding the date of the lease, such readjustment of terms and conditions may be made as the Secretary of the Interior may determine. The FCLAA provides that the Federal coal lease will be subject to readjustment at the end of the primary term of 20 years and at the end of each 10-year period thereafter. (For leases issued prior to the enactment of FCLAA, the Department treats the first 20-year anniversary date that occurs after enactment of FCLAA as the "end of the primary term of 20 years"; the lease being subject to readjustment at the end of each 10-year period thereafter.)

Contrary to the assertions in the organizations' letter that readjustments occur by operation of law, we have been advised by the Solicitor's Office that the view most likely to prevail is that the statute requires action by the Department before a readjustment can occur. In several cases, the Interior Board of Land Appeals (IBLA) rulings have been premised on this assumption. Nonetheless, we have argued the contrary to IBLA through the Solicitor's Office, but no IBLA decision has expressly responded to this argument.

This interpretation that the Department must act to exercise its right to readjust has been incorporated in the regulations at 43 CFR Subpart 3451. It is consistent with the decision of the U.S. 10th Circuit Court of Appeals in the case of Rosebud Coal Sales Co., Inc. v. Andrus, 667 F.2d 949 (1982) and District Court decisions in FMC Wyoming Corp. v. Watt, Civ. No. C-83-347-K (D. Wyo. June 29, 1984), Coastal States Energy Company v. Watt, Civ. No. C-83-7303 (D. Utah August 2, 1985), and Gulf Oil Corporation and Pittsburg & Midway Coal Mining Company v. Clark, Civ. No. CIV-84-0157-C (D. New Mex. April 1, 1985). Please note that all of these cases, except Rosebud, dealt with Federal coal leases which had post-FCLAA readjustment anniversary dates.

The November 4, 1985, letter interprets the Rosebud decision as stating that FCLAA does not apply retroactively to Federal coal leases with pre-FCLAA anniversary dates. This is not the interpretation of Rosebud by IBLA or the courts. Rosebud has been interpreted to mean that a lessee has the right to adequate notice (notice prior to the anniversary date) that the Department intends to exercise its right to readjust; the regulations are consistent with this interpretation and the FMC, Coastal, and Gulf cases proceeded based on that proposition. It is our position that this interpretation is reasonable since BLM had the same right to readjust prior to 1976 as it has now. This right was not altered procedurally by FCLAA; only the substance of the readjustments changed with FCLAA.

Since the regulations (43 CFR Subpart 3451) require notice before a readjustment is effective, they also provide that untimely readjustments are waived. By regulation, the Department must first send, prior to the readjustment anniversary date, a notice of intent to readjust; it then has 2 years to send the terms and conditions of the readjustment (by regulation, this second step may occur after the anniversary date). However, BLM policy, as specified in our July 6, 1984, instructions, is to issue the notice of intent to readjust 2 years prior to the readjustment anniversary date. The BLM policy also requires the issuance of the readjustment terms and conditions 6 months prior to the anniversary date. Under the existing regulations, if the notice of intent is sent after the anniversary date, or if the terms and conditions are not sent within 2 years of the notice of intent, the right to readjust the lease is waived. The BLM policy is designed to avoid waivers.

Readjustment waiver is misconstrued in the November 4, 1985, letter as a readjustment to pre-FCLAA terms. When a readjustment is waived, the lease is not readjusted subject to pre-FCLAA terms. Rather, no readjustment occurs and the pre-FCLAA terms continue until the lease is next readjusted. Our records show that no Federal coal leases have been readjusted to pre-FCLAA terms. Readjustment processing errors have occurred, primarily in the previous Administration, and some readjustments have been waived. These errors were examined during the internal review referred to above, and the cause of the errors has been corrected.

Contrary to the suggestion in the November 4, 1985, letter, the Secretary cannot simply inform the lessees holding waived-readjustment leases that their leases will now be readjusted by operation of law without difficult and possibly unsuccessful litigation. It would be questionable whether a court would uphold an action so directly in conflict with the Department's regulations that have uniformly, since long before 1976 and repromulgated in 1979, required action by BLM in order to readjust a coal lease.

In a fundamental misunderstanding, the November 4, 1985, letter asserts that readjustments which are *currently* pending before IBLA will be treated in the same manner as the few readjustments that were waived in the past. We believe that our actions on those readjustments currently before IBLA will ultimately be upheld, chiefly because we sent timely notice of readjustment to the lessee and all three court decisions (*FMC*, *Coastal*, and *Gulf*) on the issue affirm the adequacy of such notice.

As discussed above, the Department treats the end of the first 20-year period that occurs after the enactment of FCLAA as the "end of the primary term of 20 years" provided by FCLAA. Therefore, we are applying the 10-year period to Federal coal leases subject to and readjusted after the enactment of FCLAA. The BLM also takes this position regarding Federal coal leases, subject to readjustment after FCLAA, that had the first post-FCLAA readjustment waived. A case challenging our right to readjust a lease after 10 years when there was a waiver of the right to readjust at the end of the first 20 years is currently before IBLA.

The November 4, 1985, letter states that the Department has been granting 20-year readjustments. Although this has occurred on a few occasions, it is not BLM policy and has not happened for some time. Those 20-year readjustment lease terms were approved under unusual circumstances, based on one State Office's preliminary interpretation of advice from the Solicitor's Office. However, those leases were readjusted and are subject to FCLAA 10-year diligence and 12 1/2 percent royalty for surface-mined coal.

Rather than attempt to untangle the remaining misconceptions in the November 4, 1985, letter, we will provide the facts pertinent to the leases that the letter discusses.

It is asserted that BLM improperly readjusted 22 leases by applying pre-FCLAA terms. Of the 22 leases listed, two leases (c079641 and nm063466) are pending readjustment objection and appeal, respectively. We do not expect the readjustments to be waived. One lease (u020641) has been readjusted. Two of the leases (c012894 and u039706) were also listed as improperly readjusted by IBLA; these two leases are addressed in the paragraph below. One lease (u07746) was transferred by in lieu selection to the State of Utah, effective October 11, 1983; the readjustment of this lease had previously been waived. The remaining 16 lease readjustments were waived by State Office decision, based on previous IBLA and court decisions. The readjustment anniversary dates for 15 of these 16 leases occurred between 1977 and 1980.

The letter also stated that IBLA ordered the readjustment of 21 leases without the statutory requirements. There were only 20 leases listed and we could not identify one of those 20 (u01215). Apparently, the second part of a two-number (combined) lease was listed as a separate lease. The remaining 19 lease readjustments were declared by IBLA to have been waived. They were not readjusted with pre-FCLAA terms and conditions. Ten of the 19 leases were subject to readjustment after enactment of FCLAA. The readjustment anniversary dates for seven of these 10 leases occurred between 1976 and 1980. The other nine leases were identical to the Rosebud lease (i.e., subject to readjustment prior to enactment of FCLAA), contrary to the assertions in the November 4, 1985, letter.

Finally, the letter stated that the readjustment status of 63 leases was unclear. These leases were listed in a November 4, 1985, letter to the Acting Assistant Secretary for Land and Minerals Management. There were only 62 leases tabulated in that letter. Eleven of the 62 leases have been readjusted and 48 of the leases are pending administrative remedy (either objections filed with BLM, IBLA appeals, or Civil Suits). We have identified no readjustment procedural errors concerning the 48 leases and do not expect any of the readjustments to be waived. The remaining three leases have been or are in the process of being transferred to the State of Utah via in lieu selection. A listing of the readjustment status for the 62 leases is enclosed.

In summary, we have been acting in a manner consistent with law and regulations, and IBLA has been deciding the issues responsibly. In the majority of cases, IBLA has been upholding BLM's readjustments because they have been occurring in a timely manner. A copy of this letter is being sent to David Masselli, Brooks Yeager, and Geoff Webb.

If we can be of any further assistance, please do not hesitate to contact us.

Sincerely,

Robert F. Burford

Director

Enclosures

[illegible]

United States Senate
COMMITTEE ON
ENERGY AND NATURAL RESOURCES
WASHINGTON, DC 20510

November 5, 1985

0553

The Honorable Donald P. Hodel
Secretary of the Interior
U.S. Department of the Interior
Washington, D.C. 20240

Dear ~~Secretary~~ Hodel: Don

I have received a copy of a letter dated November 4, 1985, sent to you by the Western Organization of Resource Councils, the Sierra Club, and Friends of the Earth, alleging "serious mismanagement" in the administration of the Federal Coal Leasing Program. Specifically, these groups maintain that the Bureau of Land Management has failed to apply the 12-1/2 percent royalty rate for surface-mined coal and the ten-year diligent development requirement, as mandated by the Federal Coal Leasing Amendments Act of 1976 ("FCLAA"), to all leases readjusted after enactment of the FCLAA.

Please give these allegations your immediate attention. I expect that the Department's witnesses at the Committee's November 8 hearing will be asked to comment on these charges. If well-founded, I believe these allegations could impede the Senate's progress on legislation relating to the Federal Coal Leasing Program.

Sincerely,

J. Bennett Johnston
Ranking Minority Member

JBJ:pbr

November 4,1985

The Honorable Donald P. Hodel
Secretary of the Interior
Department of the Interior
Washington, DC 20240

Dear Secretary Hodel:

We are writing to call to your attention yet another instance of serious mismanagement in the administration of the Federal coal leasing program which threatens to deprive the public of hundreds millions of dollars of revenue and unjustly enrich a handful of favored coal lessees.

It has recently come to our attention that, notwithstanding clear statutory direction, field officials of the Bureau of Land Management and quasi-judicial employees of your office are failing to apply to readjusted Federal coal leases the 12 - 1/2% royalty (8 % for coal mined by underground methods) and ten year diligence period specifically required by the Federal Coal Leasing Amendments Act of 1976 (FCLAA) and the Department's regulations. Because of this, some leaseholders are reaping a windfall that may amount to millions of dollars per year on a single lease.

As you are well aware, Congress -- reacting to massive giveaways of public coal resources and the failure of the holders of such reserves to develop them -- established requirements in FCLAA that all new leases issued after 1976 contain mandatory provisions for a minimum 12 - 1/2% royalty and diligent development within ten years. After considering the matter, Congress decided not to immediately apply these two conditions to the more than 500 leases which had already been issued, but required that such terms would be applied to each and every "old" federal coal lease on its 20 year readjustment. Approximately 130 leases have been scehduled for readjustment since the passage of FCLAA.

The Department has used the alleged application of royalty and diligence terms on readjustment as one of its prime arguments for the repeal of Section 3 of FCLAA. It has argued that the application of diligence requirements on readjustment makes Section 3 redundant.

We had assumed that the process of readjustment was proceeding smoothly. However, as we began to analyze data made available to us earlier this year on the so-called "old" coal leases, we came across troubling discrepancies.

In response to a Freedom of Information Act request, the

Department made available approximately forty non-exempt elements of its Automated Coal Lease Data System. (Additional items, including royalty and coal quality data which had previously been made available to McGraw-Hill were denied us, making it difficult to estimate precisely the dollar cost of the improper readjustments.)*

Based on that rather incomplete data made available to us, it appears that BLM State offices have granted at least 22 lease readjustments at fifteen cents per ton -- approximately one-third to one-twentieth of the statutory royalty and significantly less than readjustment royalty the Department was using in the early 1970's ** Some of these leases were also renewed for a twenty year term rather than the ten year term required by FCLAA. An additional twenty-one leases had been improperly readjusted by the Interior Board of Land Appeals where, notwithstanding the announced position of the Department, IBLA was consistantly ordering that leases be renewed without the statutory minimum. *** Readjustment to the statutory terms had not been completed for as many as 70 additional leases which might be renewed on pre-FCLAA terms under some of the rulings handed down by IBLA.****

---

* Five of the improperly readjusted leases produced 2.88 million tons of coal in 1983. They paid a total royalty of $432,000. Had the statutory royalty been imposed, based on published selling prices for these leases, the total royalty would have been $5,183,7500. Thus, the loss to the Federal treasury was over $5 million dollars. The leases whose status we were not able to determine include 11 which produced 4.944 million tons in 1983.

** The following leases appear to have been improperly readjusted by BLM State Office according to information contained in ACLDS data made available to us: SL050862, E018804, S1062605, C012894,W075207, C037277, C079641, U07746, W055246, U020668, U38727, U46484, W038597, C011646, C0125457, C09005, W075206, W073289, W030052, U039706, U020641, NM065466. It is important to note that these State Office readjustments have occurred over the past 9 years, beginning at the end of 1976 and occurring as recently as January 1, 1985 for NM065466.

*** The Interior Board of Land Appeals has ordered post-FCLAA readjustments on pre-FCLAA terms in the following cases: Kaiser Steel, 63 IBLA 363; Franklin Real Estate 71 IBLA 13; Kaiser Steel, 76 IBLA 387; Pitkin Iron, 81 IBLA 81; Consolidation Coal Company, 87 IBLA 296. A number of additional cases are pending.

These cases involve twenty-one leases: SL069291, U02785, SL068754, U01215, SL048442-05115, SL071737, U025485, SL064903, SL058575, C07518, C07519, U017354, D056724, D047201, C012894, U039706, C020740, U073039, U073040, U073041.

**** We have identified 63 leases whose readjustment staus is unclear based on the ACLDS data. These leases are described in a letter to Acting Assistant Secretary Griles of this date.

There is litle apparent rhyme or reason to the pattern of errors. Sometimes leases issued in the same month twenty or forty years ago have been treated differently. Clearly, those leases which have been readjusted to comply with the law (as well as new leases) will face a siginficant competitive disadvantage vis-a-vis those leases which were not properly readjusted.

We would like to make it clear that we are not talking about "Rosebud" leases here. In the Rosebud case, Rosebud Coal Sales Company v Andrus, 667 F. 2d 949 (10 Cir.,1982) the Department attempted in 1977 to apply the FCLAA royalty to a lease which should have been readjusted in 1975, before FCLAA passed. The Court of Appeals ruled that the leaseholder had a right to have his leased renewed pursuant to the law which was in effect at the time the renewal should have taken place. All of the leases discussed above were slated for renewal after FCLAA and were governed by its terms.

Apparently, some of the renewals at the State Office levels were made by officials who misread Rosebud as applying to post-FCLAA renewals. Because the renewals were on terms favorable to the leaseholders, they, naturally, did not appeal. The only publicly available reports of the renewals, found in the annual Federal Coal Management Reports issued pursuant to Section 8 of FCLAA, made it appear that these renewals were pursuant to FCLAA.

The situation with IBLA is somewhat more complex. Beginning with its decision in Kaiser Steel 63 IBLA 363 (1982),IBLA has read Rosebud as establishing a principal that if the slightest procedural error were made in processing a lease readjustment, the applicant had an absolute right to a renewal on the previous terms, notwithstanding the passage of FCLAA. Because the previous administration had been grossly negligent in sending out notices of readjustments, IBLA's position threatens to shelter dozens of "old" leases from the equitable royalty and diligence obligations which the law imposes on them. IBLA's application of the principals of landlord-tenant relations to the federal property power is, to say the least, unprecedented.

The underlying premise of the IBLA position on this issue: that mistakes, negligence or even a willful failure to implement FCLAA by low-level BLM employees can have the effect of nullifying the law is unprecedented and flies in the face of over 100 years of precedent dealing with public land law in this country. As the United States Court of Appeals for the District of Columbia Circuit stated in the leading case on the subject:

> The government is too vast, its operations too varied and intricate, to put it at risk of losing that which it holds for the nation as a whole because of the oversight of a subordinate official. Montana Power Co. v Federal Power Commission 185 F. 2d 491,497 (D.C. Cir, 1950), see also Albrechtsen v Andrus, 570 F. 2d 906 (10th Cir. 1978), Utah Power & Light v. U.S., 243 US 383 (1917).

IBLA, of course, in neither an independent agency nor a judicial body; it is an administrative unit established by regulation with delegated powers to render a final Departmental decision on certain issues. It acts for the Secretary and can take no action which the Secretary could not take.

It is our view that the lease readjustments discussed above are void because they do not comply with FCLAA. Therefore, as Secretary, you have the responsibility and duty to address this problem. We recognize that much of the blame for the events which gave rise to this situation occurred in a previous administration; however, the solution to the problem is your responsibility:

> The Secretary is the guardian of the people of the United States over the public lands. The obligations of the oath of office oblige him to see that the law is carried out, and that none of the public domain is wasted or is disposed of to a party not entitled to it. Knight v United States Land Association, 142 U.S. 181 (1891)

Furthermore, there is no doubt that as Secretary of the Interior you have the power to remedy mistakes made by subordinates:

> the Secretary of Interior has broad plenary powers over the disposition of public lands ... He has a continuing jurisdiction with respect to those lands until a patent issues and he is not estopped by the principles of res judicata or the finality of administrative action from correcting or reversing an erroneous decision by his subordinates or predecessors in interest. ... So long as the legal title remains in the Government, the Secretary has the power and duty upon proper notice and hearing to determine whether the claim is valid ... Therefore, even though the BLM had determined Ideal's claim to be valid and the Assistant Secretary approved as final the determination, the Department had authority to reconsider its final decision. Ideal Basic Industries, Inc. v. Morton 542 F. 2d 1364, 1367-1368 (9th Cir. 1976) quoted in Utah International v. Andrus, 488 F. Supp 962,967 (D. Utah 1979).

To remedy this situation, we believe that you should take the following steps:

1. Determine how many leases whose readjustment date came after August 4, 1976 have been issued readjustments which do not contain the statutory royalty or a ten year term.

2. Remove all further jurisdiction from IBLA over lease readjustments and announce a final position applying the FCLAA lease terms to all leases readjusted after August 4, 1976.

3. Issue orders to BLM State offices that all lease readjustments will contain the minimum 12 - 1/2% royalty and ten year term, regardless of when lease notification was sent.

4. Notify leaseholders with improperly readjusted leases that you are exercising your powers to modify their leases to reflect the appropriate statutory terms. No injustice will be done to such leaseholders who have been on notice of the relevant statutory requirements since 1976.

We believe that the facts in this matter are established and unequivocable, but we would be happy to meet with officials of the Department to discuss the most efficient approach to remedying previous administrative errors.

For more than twenty years, the Federal coal program has been characterized by repeated instances of incompetence, inconsistency, failure to comply with the law, and failure to protect the public's stake in the value of its holdings. It is a complex and highly technical program, large portions of which are hidden from public view and scrutiny. Apparently, whenever the spotlight of attention is not focused on the program, the BLM bureaucracy thinks it can give away the store.

"Business as usual" must come to an end if the coal program is to get back on its feet. We look forward to seeing you take prompt and decisive action to correct this situation.

David Masselli
Washington Counsel
Western Organization of Resource Councils

Brooks Yeager
Washington Representative
Sierra Club

Geoff Webb
Washington Director
Friends of the Earth

United States Department of the Interior
BUREAU OF LAND MANAGEMENT
WASHINGTON, D.C. 20240

IN REPLY REFER TO:
3451 (662)

July 6, 1984

Instruction Memorandum No. 84-587
Expires 9/30/85

To: State Directors

From: Director

Subject: Federal Coal Lease Readjustments DD 8/15/84

Effective immediately, new practices will be initiated with regard to the readjustment of Federal coal leases. These changes are being initiated for our own administrative purposes and are not at variance with the requirements for the timing of readjustment notifications as set by the regulations. Readjustments done in a manner that provide the notifications required by the regulations are valid. However, you are instructed to follow these practices:

1. All lessees are to receive an "Initial Notice to Lessee that Lease Will be Readjusted" not later than 2 years prior to the lease readjustment anniversary date.

2. All lessees are to receive the "Notification of Readjusted Lease Terms" not later than 6 months prior to the lease readjustment anniversary date.

3. The development of special lease stipulations shall not delay the readjustment of leases because such stipulations can be made part of the exploration and mine plans if necessary.

To ensure that these practices are effected immediately and are fully implemented, you should take the following actions:

1. For leases not yet readjusted as of the anniversary date:

   - Immediately issue "Notification of Readjusted Lease Terms."

   NOTE: If the "Initial Notice to Lessee that Lease Will be Readjusted" for these leases is not sent prior to the anniversary date, the failure to notify may result in the lease readjustment being waived in accordance with 43 CFR 3451.1(c)(1). Report all such occurrences.

2. For leases currently within 3 months of the readjustment anniversary date, and for which the "Initial Notice to Lessee that Lease Will be Readjusted" has not been issued:

   - Immediately issue "Initial Notice to Lessee that Lease Will be Readjusted."

- Concurrently issue "Notification of Readjusted Lease Terms."

3. For leases currently within 3 months of the anniversary date, and for which the "Initial Notice to Lessee that Lease Will be Readjusted" has been issued but the "Notification of Readjusted Lease Terms" has not been issued:

   - Immediately issue "Notification of Readjusted Lease Terms."

4. For leases currently within 3 to 7 months of the anniversary date, and for which the "Initial Notice to Lessee that Lease Will be Readjusted" has not been issued:

   - Immediately issue "Initial Notice to Lessee that Lease Will be Readjusted."

   - Issue "Notification of Readjusted Lease Terms" prior to 2 months of the anniversary date.

5. For leases currently within 3 to 7 months of the anniversary date, and for which the "Initial Notice to Lessee that Lease Will be Readjusted" has been issued:

   - Issue "Notification of Readjusted Lease Terms" prior to 2 months of the anniversary date.

6. For leases currently within 7 to 24 months of the anniversary date, and for which the "Initial Notice to Lessee that Lease Will be Readjusted" has not been issued:

   - Immediately issue "Initial Notice to Lessee that Lease Will be Readjusted."

   - Issue "Notification of Readjusted Lease Terms" prior to 6 months of the anniversary date.

7. For leases currently within 7 to 24 months of the anniversary date, and for which the "Initial Notice to Lessee that Lease Will be Readjusted" has been issued but the "Notification of Readjusted Lease Terms" has not been issued:

   - Issue "Notification of Readjusted Lease Terms" prior to 6 months of the anniversary date.

8. For leases currently not within 24 months of the anniversary date:

   - Issue "Initial Notice to Lessee that Lease Will be Readjusted" 24 months prior to the anniversary date.

   - Issue "Notification of Readjusted Lease Terms" prior to 6 months of the anniversary date.

Note: For all cases where the "Initial Notice to Lessee that Lease Will be Readjusted" has been issued but the "Notification of Readjusted Lease Terms" has not been issued, review the "Initial Notice to Lessee that Lease Will be Readjusted" and determine the date, specified in the notice, by which the lease terms and conditions as provided by the "Notification of Readjusted Lease Terms" must be issued. If the "Notification of Readjusted Lease Terms," and consequently the lease terms and conditions, is not issued prior to the specified date, the lease readjustment may be waived, unless the delay is caused by events beyond the control of the Department, in accordance with 43 CFR 3451.1(c)(2). Report all such occurrences.

As those readjustment activities discussed above occur, you should develop a summary of actions taken and provide a report to me of those actions, including in that report details of any instance in which you are not able to comply with these instructions. The enclosed form provides a format for the reporting of readjustment actions. This report should be provided by August 15, 1984, (Attention: WO 640). During this same period, additional guidelines currently being prepared to support the continued implementation of readjustment procedures will be formalized.

James M Parker

James M. Parker
Associate Director

1 Enclosure
Encl. 1- Coal Lease Readjustments (1 p)

COAL LEASE READJUSTMENTS

I.M. ______ STATUS REPORT

LEASE NO.	ANNIVERSARY DATE	ACTIONS				
		INITIAL NOTICE DATE	DATE BY WHICH NOTIFICATION OF READJUSTED TERMS MUST BE SENT	DATE NOTIFICATION OF READJUSTED TERMS SENT	EFFECTIVE DATE OF READJUSTMENT	PROBLEMS

FPI

United States Department of the Interior

BUREAU OF LAND MANAGEMENT
WASHINGTON, D.C. 20240

IN REPLY REFER TO:
3451 (662)
Relates to
IM 84-587 and
IB 84-307

December 7, 1984

Instruction Memorandum No. 85- 142
Expires 9/30/85

To: All SD's

From: Director

Subject: Federal Coal Lease Readjustment, Quarterly Reporting DD 1/10/85 and thereafter

In order to assess progress in the use of the Federal coal lease readjustment procedures and activities specified in IM No. 84-587 and IB No. 84-307, the enclosed reporting requirements will be implemented. These requirements will also be included in the Secretarial MBO system. Solid Leasable Minerals System (SLMS) printouts will comprise a significant portion of the reports and shall be maintained up-to-date and accurate.

The required reports shall be submitted on a quarterly basis to Director (WO-660) within 7 workdays of the completion of each quarter. The first report is due January 10, 1983. (The SLMS printout portion of the reports is not required for the reports due January 10, 1985.) Solid Mineral Operations Division will analyze and compile reports and brief me on the findings.

The BLM Federal coal lease readjustment manual 3451 is under review and will be revised to enhance the readjustment process. The readjustment processing schedules as outlined in IM No. 84-587, July 6, 1984, are still in effect. Questions regarding this report should be directed to Paul Politzer, WO-660, at FTS 343-7722.

George F. Brown

George F. Brown
Deputy Director, Energy and Mineral Resources
Acting

1 Enclosure:
Encl. 1 - State Director Quarterly Report Federal Coal Lease Readjustments (3 pp)

STATE DIRECTOR
QUARTERLY REPORT
FEDERAL COAL LEASE READJUSTMENTS

Frequency: Quarterly
Due Date: 7 workdays following completion of each quarter
Recipient: Director (WO-660)

The Quarterly Report consists of 3 parts, as follow:

Part 1: Summary
Part 2: Solid Leasable Minerals System (SLMS) Readjustment Data Printout
Part 3: SLMS Readjustment Protest/Appeal/Civil Suit Printout

Part 1 (Summary)

Federal coal leases to be included:

- All leases with an anniversary date between January 1, 1984, and the end of the reporting quarter plus 2 years (e.g., for the report due January 10, 1985; include all leases with an anniversary date between January 1, 1984, and December 31, 1986).
- All leases for which the anniversary date has passed and the leases are still pending readjustment.

See Enclosure for Part 1 Format. Also included in the enclosure is a sample and explanation.

Part 1 shall be updated quarterly and resubmitted. Readjusted leases will be retained in the report.

Part 2 (SLMS Printout)

A SLMS program will be developed by WO-660 for the generation of this part of the report. The State Office will be instructed on the use of the query program when developed. All leases included in Part 1 shall be included in this part.

Part 3 (SLMS Protest/Appeal/Civil Suit Printout)

A SLMS program will be developed by WO-660 for the generation of this part of the report. The State Office will be instructed on the use of the query program when developed. All leases for which a protest, appeal or civil suit has been filed subsequent to January 1, 1984, shall be included in this part.

SAMPLE

STATE OFFICE: ____________________

STATE DIRECTOR
QUARTERLY REPORT--PART 1
FEDERAL COAL LEASE READJUSTMENTS

Report Date:______

Page 1 of 1

NOTE: RECORD LEASES CHRONOLOGICALLY BY ANNIVERSARY DATE

Lease Number	Readjustment Anniversary Date	Date Initial Notice Sent To Lessee	Status (See Below) Check Appropriate Columns							Date Terms and Conditions Must Be Sent to Lessee	Date Terms and Cond. Sent to Lessee	Contest Status (See Below) Check Appropriate Columns								Was Adjmt. Waived	Effective Date of Readjustment
			(1)	(2)	(3)	(4)	(5)	(6)	(7)			(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)		
x7654	1/4/84	9/1/83	X	X	N/A	N/A	X	X	X	9/1/85	2/1/84	X	X	X						No	4/1/84
x7990	6/1/84	8/1/84	X	X			X	X	X	8/1/84	8/1/84	X	X							Yes	--
x9742	9/1/84	3/1/84	X	X	X			X	X	8/1/84 (3/1/86)	8/1/84									No	9/1/84
x10075	2/8/85	8/1/84	X	X	X	X	X	X		12/8/84 (8/1/86)											
x11122	9/1/85	8/1/84	X	X	N/A	N/A				3/1/85 (8/1/86)											
x22247	12/15/86	12/1/84	X	X	X					6/15/86(12/1/86)											

NOTES ON SAMPLE: --x7654 and x11122 N/A, not applicable entered for Status, Column 3, as the surface is BLM administered.
--x7990 adequate time did not exist to request SMA Comments
--x9742 to x22247 in the "Date Terms and Conditions Must Be Sent" column the first date is the submittal date as required by IM 84-507; the second date is the date specified in the initial notice

Status:
(1) Initial Notice Sent to Lessee
(2) District Office Recommendations Requested
(3) SMA Recommendations Requested
(4) SMA Comments Received
(5) District Office Recommendations Received
(6) Terms and Conditions Sent to Lessee
(7) Attorney General Notified

Contest Status:
(1) Protest Pending
(2) Protest Decided
(3) Appeal Pending
(4) Appeal Decided
(5) 1st Civil Suit Pending
(6) 1st Civil Suit Decided
(7) 2nd Civil Suit Pending
(8) 2nd Civil Suit Decided

Enclosure 1-2

Readjustment Status as of September 30, 1985, for 62 Federal Coal Leases Identified in November 4, 1985, Letter to Assistant Secretary Griles

NOTE: No Currently Pending Lease Readjustments are Expected to be Waived

R =Readjusted
RC=Readjustment under Civil Suit
RA=Readjustment under Appeal to IBLA
RO=Readjustment Pending Objection filed with State Office
RD=Readjustment Objection Decided, Time to file Appeal has not Expired

Serial Number	Date Issued	Status
SL031286	09/04/23	RO
C033800	10/08/24	RO
D034365	10/25/24	RA
D051698	09/11/41	RO
SL062583	09/11/41	RC
SL063058	08/03/42	RC
SC32582	09/09/43	R
SL062966	11/12/43	R
SF077115	07/27/44	R
SL064507	11/01/44	R
D052558	12/14/44	RO
SL064900	02/03/45	RA
D052547	03/01/45	RO
W054727	11/01/61	RA
W054728	11/01/61	RA
W054737	11/01/61	RA
U067498	01/01/62	RA
U020305	03/01/62	R
U040151	03/01/62	RA
U053995	03/01/62	RA
U083066	03/01/62	RA
U089096	07/01/62	*
U090231	11/01/62	RA
U092147	12/01/62	*
C023703	03/01/63	RA
W061421	03/01/63	RC
W061422	03/01/63	RC
C024998	10/01/63	RO
C081330	11/01/63	RA
U0126947	12/01/43	R
U0126948	12/01/63	R

*Being transferred to State of Utah; readjustment Civil Suit withdrawn.

NOTE: No Currently Pending Lease Readjustments are Expected to be Waived

R =Readjusted
RC=Readjustment under Civil Suit
RA=Readjustment under Appeal to IBLA
RO=Readjustment Pending Objection filed with State Office
RD=Readjustment Objection Decided, Time to file Appeal has not Expired

Serial Number	Date Issued	Status
U073120	02/01/64	RD
C0114093	05/01/64	RO
U083005	08/01/64	R
U084923	08/01/64	RA
U084924	08/01/64	RA
U0142235	10/01/64	RA
C029889	11/01/64	RD
M065329	12/01/64	R
U083000	12/01/64	R
C0115606	01/01/65	R
C0125485	01/01/65	RO
C12638	01/01/65	RO
C7835	01/01/65	RO
U0140770	01/01/65	RA
W0220516	03/01/65	RO
W0256663	03/01/65	RO
C081251	05/01/65	RO
C081258	05/01/65	RO
C0117192	06/01/65§	RO
U0101213	06/01/65	RO
U0101214	06/01/65	*
U0101215	06/01/65	RO
U0101217	06/01/65	RO
U0101218	06/01/65	RO
U0105404	06/01/65	RA
U098774	06/01/65	RA
U098775	06/01/65	RA
W0312918	06/01/65	RO
W0313559¶	06/01/65	RA
M069782	07/01/65	RA
W0312311	07/01/65	RA

§November 4, 1985, letter listed issue date as 06/01/85.

*Transferred to State of Utah effective February 8, 1985.

¶November 4, 1985, letter listed serial number as W0313550.

NOTE: No Currently Pending Lease Readjustments are Expected to be Waived

SUMMARY OF STATUS FOR 62 FEDERAL COAL LEASE READJUSTMENTS

11: R =Readjusted
4: RC=Readjustment under Civil Suit
22: RA=Readjustment under Appeal to IBLA
20: RO=Readjustment Pending Objection filed with State Office
2: RD=Readjustment Objection Decided, Time to file Appeal has not Expired
59: Total

In addition, two Federal coal leases are currently being transferred to the State of Utah via in lieu selection; their readjustment Civil Suit has been withdrawn. One Federal coal lease was transferred to State of Utah via in lieu selection effective February 8, 1985. Total of 62 Federal coal leases.

Senator Wallop. Thank you very much, Mr. Griles.

Senator Bingaman, do you have questions?

Senator **Bingaman**. Yes, I did have a couple of questions. Thank you.

Let me just ask if I understand correctly, the administration's position is that there should be no time limit on the holding of these Federal leases; is that right?

Mr. **Griles**. Senator, we believe that currently there's a 40-year mine-out provision for a Federal lease currently in the statute. That 40-year mine-out, if one was to allow the process and concept that we talked about—that is, a company, once it acquires a lease, it has *x* many years, 10 years, 12 years, whatever the committee would decide, to begin production. If it does not begin production, it should immediately begin to pay a fee, a creditable fee toward future production.

Now, the executives in this room who would make that decision are going to have to make a decision that either they're going to produce coal within that *x* time or they're not going to produce coal. As it is, we have a number of leases today, pre-1976 leases, which do have the terms and conditions on the lease, and either they'll produce or turn them back.

We don't think that that allows the market to appropriately work, and to simply turn them back doesn't give the public the benefit of having the coal produced or, more importantly, revenues to the Federal and State systems that benefit.

Senator **Bingaman**. So a leaseholder could begin to pay the fee in the 11th year and then continue for how long to hold that lease?

Mr. **Griles**. As long as he's paying to us the appropriate amount of money, which we think would be significant. The average lease would be—an analysis in the report is about $250,000 a year until the market was ready for that coal to be produced.

Senator **Bingaman**. $250,000 a year. What does that relate to now?

Mr. **Griles**. It relates to the average kind of lease that's out there and the kinds of reserve figures that were in that lease. It's a hypothetical mining situation that we looked at within the report.

Senator **Bingaman**. OK. But as I understand your proposal, the answer to my question is yes, that you do not contemplate any time limit on the length of time a leaseholder could hold the lease.

Mr. **Griles**. That's correct, Senator.

Senator **Bingaman**. Let me ask about this crediting of the fee. You talk about how as the fee accumulates, there is an incentive provided for them to go ahead and mine, and I guess the incentive increases because they can get their money back.

Mr. **Griles**. That's correct.

Senator **Bingaman**. I'm just wondering. I mean another way to look at that would be that essentially we are contemplating a situation where a leaseholder would be able to hold the lease indefinitely and assuming that they ever mined, they would be held harmless from any kind of rental fee for the full duration or any kind of a holding fee during the time that they had it over the 10 years; is that right?

Mr. **Griles**. Well, the first 10 years of the lease would be an opportunity to get the lease permits, mine developments started, and get the contracts. Ten years is probably an unrealistic timetable in terms of the current situation with all the problems, but assuming it's 10 years, at that point if they were not in production and they were not producing commercial quantities—and commercial quantities means 1 percent of the reserve figures of that lease—they would then have to pay a royalty, an advance royalty on that which they're not producing.

Senator **Bingaman**. Yes, but what I'm saying is, suppose they start paying that fee on the 11th year and they keep it up for 30 more years. On the 41st year, they finally go into production and then they get back all the money that they spent between the 11th and the 41st year. Is that you understanding?

Mr. **Griles**. No, Senator. The proposal we have is that the advance royalties can only be credited for a 10-year period. In other words, a rolling 10 years. And then after that point, they will not get credit for that. So it is a penalty plus a credit.

So the incentive for production occurs——

Senator **Bingaman**. On a 10-year basis. So they would have a great incentive, say, toward the end of the second 10 years, and then on the 21st year they'd have no incentive.

Mr. **Griles**. No, it still continues to be incentive because they continue to have——

Senator **Bingaman**. Oh, it's a rolling 10.

Mr. **Griles**. Yes.

Senator **Bingaman**. Oh, OK.

Mr. **Griles**. So the incentive is always there and it just gets bigger, up until the 20th year. And then after that, another 10 years picks up.

The point is, Senator, they have a 1 percent of the reserve base, and if that reserve does not then produce, it doesn't decline.

Senator **Bingaman**. I'm still not clear, I guess, on how at the end of—if at the end of the first 10 years they're not in production, there's a holding fee imposed upon them. That continues to be charged yearly for the 10 years. At the end of that 10 years, if they're not in production, a second 10 years starts, and that starts accumulating?

Mr. **Griles**. It's an annual rollover.

Senator **Bingaman**. So if you started the 22d year, how much of a reimbursement would you get? Would you get 2 years or would you get 12 years or would you get——

Mr. **Griles**. You would get the previous 10 years.

Senator **Bingaman**. The previous 10. Then you'd get the previous 10 no matter when you started production.

Mr. **Griles**. That's right.

[Subsequent to the hearing the Department of the Interior submitted the following:]

I would like to clarify the proposed 10-year limit on crediting advance royalties. Although the Department's study did not specifically address this issue, and our previous testimony did not mention any limit, we are recommending that no more than the previous 10 years of payments be creditable against royalties later due on production. The distinction is, in fact, academic as it is highly unlikely that a lessee would be willing to make payments in the amount we have suggested for as long as 10 years, since they would be unable to recoup the cost of money over that or a longer time in profits. The reason for this is that after 10 years of payments (20 years after lease issuance) the discount rate would make the value of the credit so small that there would be no effective difference to the lessees. Furthermore, from an administrative viewpoint, it is much better to clear the books at the end of 10 years rather than have credits carry on indefinitely.

Senator BINGAMAN. Let me ask about assignment if I could, lease assignments. How does that fit into your plan? Suppose a company has a lease, doesn't get it under production the first 10 years, doesn't get it under production the next 7 or 8 years, and then assigns the lease to someone else. What happens there? Does the assignee just take it as if the assignee were the original leaseholder?

Mr. GRILES. In terms of the lease, he would assume the lease as it was. He could not and would not receive the credits.

[Subsequent to the hearing the Department of the Interior submitted the following:]

Our initial thought is that credits should not be transferable. However, the issue should remain open. We do not want any more Government restrictions on the market than necessary. Assignments are financial considerations that should be made between the buyer and seller with a minimum of Government interference. On the other hand, a great deal depends on the tax implication of transferring credits. If these tax considerations do not cause any serious problems, then it would make no real difference whether the credits could be transferred.

Senator BINGAMAN. So there would be no incentive for the assignee to develop the coal.

Mr. GRILES. He would start his timeframe within the assignment requirements of the rules and regulations. But it would not be an advantage for the company to walk away from the lease. In other words, the first company that owned the lease had paid *x* amount of dollars on advance royalties. The second company that acquired the lease would not get that benefit. He would have to start, and he would have to meet the requirements of the lease.

Senator BINGAMAN. At some stage down the road after a company has held these leases and has not done anything with them for some period of time, it's your position that there should never be a time limit on when they can assign those.

Mr. GRILES. Senator, let's recall that this is on new leases to be let, and we assume that on these new leases specifically from the new terms, when we have a coal leasing to occur, that there will be a market for that coal and that we won't have to worry about it.

On the pre-1976 leases which this applies to, it would, I think, force a number of companies which are holding these leases to finally make a financial decision to either revert these leases back to the Federal Government or pay for holding them, and they don't have that incentive today.

There is no reason for them to make that financial judgment.

Senator BINGAMAN. But I'm unclear; a company that holds a pre-1976 lease would have three choices. They could go ahead and develop the lease, they could pay the holding fee, or they could assign it.

Mr. GRILES. That's right.

Senator BINGAMAN. Is there any point at which you think it's in the interest of the Federal Government to deny them the right to continue to assign that lease?

Mr. GRILES. That's a good question, Senator. I'll have to admit that I haven't given that thought that probably I should to answer you. I'd like to do that and get back to you on that.

[The information follows:]

We would rather not place artificial restrictions on the market. As long as another company is willing to obtain a lease in order to try and get it into production we see no reason for denying the assignment. Keep in mind that, under our recommended structure, the act of assignment would in no way relieve or postpone the requirement for payment of the minimum royalty.

Senator BINGAMAN. OK. Thank you very much. That's all I had, Mr. Chairman.

Senator WALLOP. What would be the administration's position with respect to railroad mining affiliates leasing outside the checkerboard?

Mr. GRILES. We would not oppose a railroad affiliate leasing outside the service area of that railroad that it is affiliated with. For instance, Santa Fe's affiliate leasing in the UP area or in BN's area, or vice versa, we welcome competition and opportunity.

Senator WALLOP. I'm concerned again about the public's interest in the public's coal with regards to mining plans that must make decisions and go off in opposite directions. It seems fairly clear to anybody who's ever read those things that those tracts, as you suggest, would never again become logical mining units, in which case the public's interest in protecting itself has protected itself out of an interest in perpetuity.

Is that pretty much the way it would happen on that type of lease?

Mr. GRILES. That's correct, Senator. A specific example—and you have witnesses, I'm sure, who will testify to more than I—but there is in New Mexico the issue of Santa Fe's affiliate, where there is Federal coal. And as I recall the facts, and they may be incorrect, but I hope they will correct me today if I am—there's about 150 feet of Federal outcrop coal that is left there that can't be mined by anybody else, ever, under the market conditions that I would ever see. And that coal would be left unless we found a way that that coal could be mined by that company when it is mining its coal and its State's coal which is its lease.

We're working out some land exchanges with them for that coal within the Chaco National Park. But we've had to find a way in the public interest to do that. We think that's just one example of how the process doesn't work, though.

Senator WALLOP. It doesn't do much for protecting a State's interest either at that moment.

Well, how would the disclosure of information regarding contracts be anticompetitive?

Mr. GRILES. We don't think that disclosure of the information from the ICC to the Secretary—that is, the information on coal contracts—would impair and would be anticompetitive, because we wouldn't make the information available either.

I think that the Department of Justice, Antitrust Division, has indicated in their judgment that the market wouldn't be anticompetitive if the railroads entered it. So what we're trying to do is to be sure that the affiliates don't get some advantage over the other competitors within the same marketplace. And by making these coal contracts, shipment of contracts available in the ICC, they can look and see if there's some disparity within these contracts and they can decide whether or not it is. And if they do, they inform the Department of the Interior. And the reason is the coal price will be driven down by that and the rail rate will be higher.

We simply would collect a royalty based on the disparity of the two contracts, and the public's benefit from that could be kept.

Senator **Wallop**. But how would a coal producer or coal shipper assure himself that the railroad was not charging a lower rate to its producer affiliate? The ICC and the Justice Department and Interior Department might know that, but then the shipper might come along and say well, it sure feels like it.

And at what point in there would they be entitled to sufficient information to reassure themselves that that was not the case?

Mr. **Griles**. Well, Mr. Chairman, I have to admit an ignorance of the ICC program and process, of how the coal shipment rates are made available to the public and when. I know that's a bone of contention among many shippers as to what contract rates are.

That is obviously something that the ICC could deal with if you chose that that is how they would deal with it, by making that kind of information available in a competitive situation so that there would be assurances that all parties had equal right to similar rates.

Senator **Wallop**. Let me shift gears here for just a second. The analysis that you provided indicates that Congress must pay close attention to the tax consequences of imposing a holding fee. The analysis would indicate that the graduated fee proposed under S. 372 or S. 570 would not be deductible in the year paid under current IRS regulations.

Could you explain what the parameters are under current law, whether calling the charge a holding fee, a penalty, or an advance minimum royalty makes a difference? And would you also explain what the current administration tax proposal might do to the whole discussion?

Mr. **Griles**. I don't think I can fulfill all of those mandates here today. I'm not sure that there's anyone that can on some of those issues, particularly the tax proposal.

Senator **Wallop**. Well, several of us better, I think, before we launch ourselves into that program.

Mr. **Griles**. I think what we probably need to do is give you an analysis from both Treasury and Justice to look at that. But, briefly, we do know that IRS does consider creditable royalty payments deductible, but how they consider them, whether they're noncreditable and escalating, when they can be deducted, could have a dramatic impact on the level that you should charge and what the impact will be on the profitability of the company.

I think that before the committee makes a decision, it needs to have that understanding. And, I think, our proposal recommends that it be creditable and it not be escalating, so that the IRS—it can be deducted in the year that it's paid. That's my understanding of the issue. We'd like to submit some detailed analysis and ask Justice or Treasury to do that.

[Subsequent to the hearing the Department of the Interior submitted the following:]

We will forward to the subcommittee suggested draft letters the subcommittee may consider sending to Treasury in an attempt to respond to your questions.

Senator **Wallop**. Well, I must say I like the idea, as you described it, of providing the incentive to get into production with these advance royalties and other things. It strikes me that in addition to responsible management of mineral resources, it as well becomes a consumer interest because produced coal is coal that is competitive within the marketplace and withheld coal is not. And each time we have to roll back or take back a lease in which some development costs have been expended, losses to the Treasury in terms of obvious business losses that can be deducted, there's losses in time, there's losses in a capital-short country which need not spend capital that cannot be recouped.

All of those things add to the price of coal once it is produced, and so I very much appreciate the incentive nature of that. It may not be precisely the way we end up, but something like it I hope is where we end out and I appreciate it.

I am about to take off to go look at the coal regions of Wyoming, cold and windy as they may be this weekend. Senator Ford has agreed to chair the next hour of it.

Senator **Ford**. Next 30 minutes.

Senator **Wallop**. Next 30 minutes? After I leave I don't care what you do. My relief is here. You take care of yours.

Senator **Ford**. Senator, it just depends on how you spell "relief."

Senator **Wallop**. TGIF.

Mr. **Griles**. One thing we would like to submit for the record is the chart of the total royalty payments that would have an impact on the State and the Federal Treasury, which would show a minimum royalty and what the revenue curve would be, because we do think it's important that we maintain some revenue flows, particularly revenue flows to the States when you have an advance royalty to the States. So when the crediting would start, it wouldn't be just a drop when production starts, as we talked about with Senator Bingaman.

Senator **Wallop**. I think that's one of the concerns that some of us have, and I appreciate that.

Mr. **Griles**. We've given copies to the clerk.

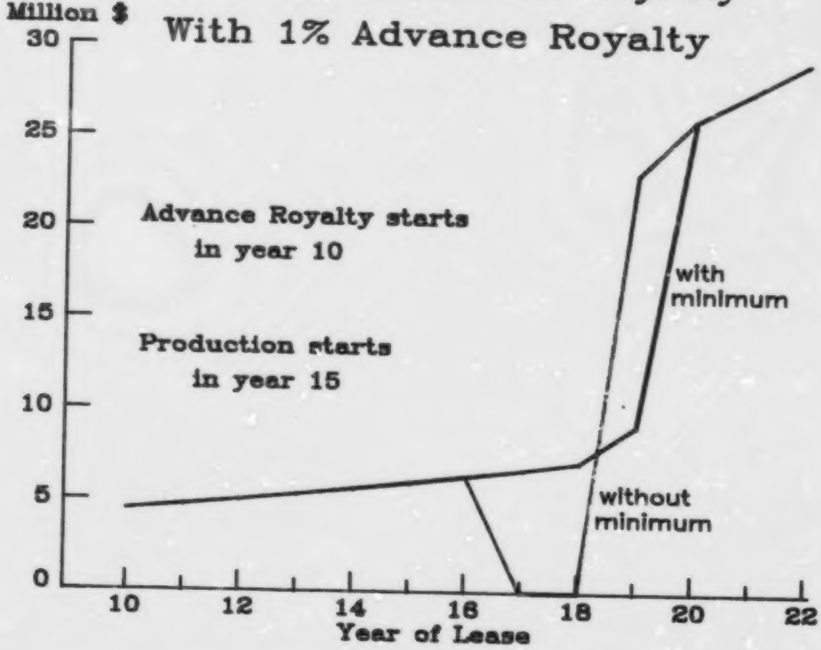
Senator **Wallop**. It will be part of the record and I thank you.

[The chart follows:]

Total Royalty Payments

Effect of Minimum Royalty

With 1% Advance Royalty



Senator **Bingaman**. Could I just ask some questions about that chart? I don't want to hold things up, but this chart tries to portray the royalty payments and you built in assumptions about when people are going to start production and get their money back?

Mr. **Griles**. That's correct, Senator. That's exactly right.

Senator **Bingaman**. So you still get a major increase in royalty payments anticipated, even with people starting production.

Mr. **Griles**. Absolutely.

Senator **Bingaman**. Down the road.

Mr. **Griles**. Yes.

Senator **Bingaman**. And the 10-year rolling part doesn't interfere with it significantly. You've got that built in, too.

Mr. **Griles**. Yes, that's correct.

Senator **Bingaman**. So that beyond the 20th year—OK, great. Thank you.

Mr. **Griles**. Thank you. Senator.

Senator **Wallop**. Again, I thank you. I am going to turn it over to Senator Ford to whom I express a great appreciation for this, and assure him that his relief is secure.

Thank you very much.

[Pause.]

Senator **Ford** [presiding]. The next witness is going to be the attorney general of the State of New Mexico, Paul Bardacke. Bardacke, is that correct?

We just have Smiths, Jones, and Fords in Kentucky. But how about me just calling you General?

Mr. **Bardacke**. That will be fine, Senator. [Laughter.]

Senator **Ford**. General, your full statement will be included in the record, so if you want to summarize it that would be fine. I'm sure the distinguished Senator from New Mexico will want to ask you some questions as we proceed and we'll be glad to hear your testimony.

STATEMENT OF PAUL BARDACKE, ATTORNEY GENERAL, STATE OF NEW MEXICO

Mr. **Bardacke**. Thank you very much, Senator. I appreciate being invited to appear before the subcommittee to comment on proposed changes in the Mineral Leasing Act. I support diligent development of leased Federal coal lands as sound public land management, and to urge that economic penalties be required from lessees of nonproducing pre-1976 coal leases.

New Mexico has inherited the promises and problems of Federal coal development, but has enjoyed very few of the benefits. Large blocks of leased but undeveloped Federal lands are located in the remote San Juan Basin of our State. Fewer than 10 of the 30 Federal leases in New Mexico are included in active mining operations in the Basin. The area is rich in unique environmental values, in cultural resources, and for 20 years coal development has been vehemently opposed by a number of interest groups, including a large portion of the local native American population.

At the same time, industry has been clamoring for new railroads, rail lines and public services in the Basin to support their proposed mining operations. The result, I might add, in our State has been near chaos. Although New Mexico did not participate in the decisions 20 years ago to lease Federal lands in the Basin and it received next to nothing in the process, the State has now been forced to respond with endless studies of the potential mining impacts and to prepare plans to accommodate the repercussions of coal development that might not even occur.

Meanwhile, some coal companies have looked elsewhere and begun mining on lands that do not contribute Federal royalty income to the State. Although 45 percent of New Mexico's coal lies on Federal lands, Federal coal production provided a scant 10 percent of the production in the State last year.

The cost to the State, stemming from the long-term holding of nonproducing leases has been high and personal hardships have sometimes been great. It is time for companies to begin to pay for the right to hold on to land leased before 1976.

The intent of Congress in 1976 to promote development or relinquishment of pre-1976 leases through section 3 of the Federal Coal Leasing Amendments Act was, and it remains sound. But I fear enforcement of the provisions as it now stands could adversely affect western energy development in general and New Mexico's oil and gas industry specifically.

Economic sanctions, if set high enough, can achieve the same objectives, while providing much needed income to the State. I therefore urge that section 3 be amended to require payment of an annual, nonrecoupable economic penalty by lessees as soon as they have held a nonproducing coal lease for 10 years.

I think that the point that Senator Bingaman was getting at when asking why have it be recoupable is an excellent one. I think by making the entire payments to the State and Federal Government recoupable, there is a tendency to make a false incentive to produce the coal. I think coal should be produced based on its economic viability and the recoupment of that fee should not go into the equation.

I think that with respect to section 7, it is one of the pillars of the new leasing program set into place in 1976 and it is necessary to ensure that the legacy of past leasing mistakes will not be repeated in the future. To remove or weaken this pillar is to undermine the stability and effectiveness of the leasing program.

So I think that the section 7 diligence requirements should be left alone. And I think that by changing it, altering it, not requiring relinquishment of those leases that companies knew that when they took them in 1976 and thereafter that it was in place, that would only create new controversies and obstacles to continue leasing of western public lands.

The penalty that I'm proposing for inclusion in section 3 should be set high enough so that the cost of holding onto a lease approximates the cost of obtaining a new one. This will encourage lessees to retain only leases with good short-term development prospects, and to relinquish those leases encumbered with serious obstacles to develop.

Used in this way, the sanctions can partially replace the land use planning that should have taken place before the leases were issued in the first place. Moreover, the sanctions will help remove the economic advantage enjoyed by many owners of the pre-FCLAA leases and to improve competition within the western coal industry.

And finally, the sanctions will recoup some revenue to the Federal and State governments lost during the era of giveaway leasing policies. While economic penalties and desirable and consistent with the goals of section 3, the much discussed lease turnback option is antithetical to those goals and a disastrous public policy.

The turnback option will convert undeveloped leases from liabilities under the section 3 diligence rules. Because of section 3, they will now, if a turnback policy is developed, turn into assets to be banked for future use.

Turnbacks reward those companies that are likely to be the biggest violators of section 3, while punishing companies that have acted in good faith and relinquished leases in the face of the current version of section 3. The concept of turnbacks should be rejected.

And finally, I urge an action of a requirement that pre-FCLAA leases be automatically raised upon readjustment to the levels required in FCLAA. In New Mexico, the difference between the royalty rates included in pre-1976 leases and those rates required by FCLAA amount to about $2 per ton or about $2 million per year to the State at current production levels.

Any failure to eliminate the antiquated royalty schedule at readjustment and any delay in adjusting royalties fully to the levels required in FCLAA will have serious economic consequences in New Mexico.

These potentials for such adverse consequences can and should be avoided permanently by prompt congressional action.

Thank you very much.

[The prepared statement of Mr. Bardacke follows:]

Attorney General of New Mexico

PAUL BARDACKE
Attorney General

P.O. Drawer 1508
Santa Fe, New Mexico 87504
505-827-6000

KAY MARR
STEPHEN WESTHEIMER
Deputy Attorneys General

TESTIMONY OF PAUL BARDACKE
NEW MEXICO ATTORNEY GENERAL
BEFORE THE SENATE SUBCOMITTEE ON NATURAL RESOURCE DEVELOPMENT AND PRODUCTION
CONCERNING REVISIONS TO THE FEDERAL COAL LEASING AMENDMENTS ACT
NOVEMBER 8, 1985

Good morning. My name is Paul Bardacke and I am Attorney General for the State of New Mexico. I would like to thank the Subcommittee for giving me the opportunity to comment on proposed changes to the Federal Coal Leasing Amendments Act (FCLAA). Section 3 of FCLAA provides sanctions for the failure to diligently develop coal leases issued prior to FCLAA. Section 7 provides sanctions for failure to develop diligently post-FCLAA leases and those pre-FCLAA leases which have been readjusted to include the diligence requirement of Section 7. I support the retention of the diligence concept in Section 3 of FCLAA. I urge, however, that Section 3 be amended to replace or supplement the current sanction, which prohibits acquiring any new lease, with a sanction entailing economic penalties. I am opposed to major statutory revisions to the Section 7 diligence system. Finally, I oppose revisions to FCLAA that would permit holders of pre-FCLAA leases, whose leases come up for readjustment, to obtain lease provisions that would reflect anything less than full and fair royalty rates.

New Mexico has inherited all of the promises and many of the problems associated with the extensive federal leasing activity that occurred in the State in the 1960s, but so far it has enjoyed few of the benefits. There remains a large backlog of undeveloped federal coal leases and pending preference right lease applications (PRLAs) in New Mexico that are not providing jobs, tax revenues, or royalty income to the State. Indeed, although an estimated 45% of New Mexico's coal reserves lie under federal lands, only about 10% of the coal production in the State last year came from federal lands. Just 10 of the 30 existing federal leases are part of active mining operations.

While most federal coal lands in New Mexico sit undeveloped, coal companies are looking for development prospects elsewhere. During the past year, a large coal mine has opened on private land in New Mexico. The Navajo Nation has been vigorously pursuing a coal mining and power generation project that could tap its vast coal holdings in the San Juan Basin.

The pre-FCLAA leases were awarded at industry's request with little or no State participation in deciding where or when they were issued. Lease issuance fees were minimal. Revenue flow to the State from undeveloped leases is insubstantial. Yet, the existence of these undeveloped leases, while creating little benefit to the State, has created a number of problems. Most of the undeveloped leases and PRLAs are located in the remote, sparsely populated, and environmentally fragile central portion of the San Juan Basin. Lawsuits to block or in someway redirect development away from this region have been filed by a number of groups. Such suits include those by Native Americans living in the Basin who perceive coal mining as a threat to their livelihood and traditional cultural values. Environmental groups have vehemently opposed new leasing and development of existing leases in the area. Industry has clamored for expansion of transportation and other public services necessary to mine and market leased coal reserves. To address such concerns, the State has been forced to study the potential impacts of coal development in the San Juan Basin and to participate in complex planning processes and lawsuits. All of this has gone on even though we do not know if or when coal development will actually occur.

In short, past leasing activity has resulted in a coal development scenario for federal lands in New Mexico that is less than ideal. Perhaps more than most western states, New Mexico has suffered from coal development problems created through inadequacies in the pre-1976 federal leasing program. The holding of non-producing federal coal leases for long periods of time has resulted in high costs to the State, uncertainties in State energy and natural resource use planning, and personal hardships.

While the undeveloped leases create problems for the State, I also recognize that a lot of money and time has been invested in federal land coal development, not only by the State, but by a number of companies holding undeveloped federal leases. The State remains prepared to encourage coal development as long as environmental and socioeconomic concerns are considered and as long as the State receives a fair economic return for these leases. We have no desire to coerce development, as opposed to relinquishment of pre-FCLAA leases. Neither do we wish to impede the growth of an economically viable coal industry. What we do want is for companies to begin to pay for the right to hold non-producing pre-1976 coal leases for which they paid next to nothing and because of which New Mexico has been saddled with numerous burdens.

How do these considerations translate into positions with regard to proposals to amend FCLAA? First, our experience indicates that diligent development of leased federal land is a sound public land management concept. The intent of Congress to promote development or relinquishment of pre-FCLAA and post-FCLAA leases was and continues to be appropriate. But some circumstances have changed since 1976 -- such as a softening in demand for western coal -- which indicate that strict enforcement of Section 3 as it now stands would adversely impact energy development in the western United States. Economic sanctions, if set at an appropriately high level, can achieve the objectives of Section 3 and provide a much-needed revenue flow to the states.

Pre-FCLAA leases will continue to be special cases in the federal leasing program that require special treatment. Section 3 provides a method to rectify or at least minimize leasing mistakes which were made prior to the corrective action taken by FCLAA. Economic sanctions should be adequate to enforce the objectives of Section 3. Additional factors must be considered when one considers post-FCLAA leases and readjusted pre-FCLAA leases which were written with specific requirements of diligent development as mandated by Section 7 of FCLAA. Section 7 is central to the statutory scheme of FCLAA. Together with pre-lease land use and activity planning and a competitive leasing process, the Section 7 diligence requirement is necessary to ensure that leasing mistakes of the past will not be repeated. Any significant change to the leasing system of FCLAA so soon after its enactment can only undermine the effectiveness of the program, erode public confidence in the program, and create new obstacles to continued leasing of western public lands.

Specific recommendations with regard to several proposed revisions to FCLAA follow.

Section 3 should be amended to provide for payment of economic penalties. I am opposed to the repeal of Section 3 as proposed in S.570. I favor an amendment to Section 3 which would require lessees who violate Section 3 to pay an economic penalty if they wish to retain noncomplying leases.

Having examined several types of economic penalties, I believe that nonrecoupable rental payments are preferable. They assure a continuous revenue flow to states from leases and they resolve our principal concern: to insure income from non-producing leases, while not forcing production. To this extent, I agree with the rental provision contained in S.372. I believe, however, that the appropriate measure of the rental payments should be related to the size of the coal reserves on a lease tract, not the number of acres, as proposed in S.372. The resource of value in federal leases is coal not land and the level of payments should be tied to the value of the lease.

The goal of the rental payment must be established before an appropriate amount for the payment can be set. The payment can be set low enough to preserve an economic advantage to lessees of pre-FCLAA lessees. Payment can be set so as to put lessees of pre-FCLAA and post-FCLAA leases on an equal economic footing. Finally, payments may be set high to force relinquishment of pre-FCLAA leases.

The goal of putting pre-FCLAA and post-FCLAA leases on an equal economic footing is the most sensible one. Economic penalties should be set so that the cost of holding a pre-FCLAA lease would be roughly equivalent to the cost of obtaining a new lease. Lessees of pre-FCLAA leases would then have an incentive to hold only those leases with good short-term development prospects. Leases with development problems, including those created by environmental conflicts, poor coal quality, or lack of transportation, are likely to be relinquished because, for the same amount of money, the lessee can try to obtain a new lease without those encumbrances. Used in this way, the economic sanction will help protect those interests which, in leases issued since 1976, have been protected by planning procedures and competitive leasing procedures required by FCLAA.

New Mexico wishes to receive a revenue flow from undeveloped coal leases as quickly as possible, without punishing lessees. This can be accomplished by amending Section 3 to require that rental payments begin as soon as a lessee has held a non-producing lease for 10 years as provided in the "holds and has held" test of Section 3. Amending Section 3 so that economic sanctions would not be imposed until the next lease readjustment amounts to an unjustified delay in instituting rental payments at a high cost to the state. Providing for economic penalties only if and when a lessee violating Section 3 seeks to obtain another lease is also likely to reduce seriously income to the State.

Another advantage of the rental payment scheme outlined above is that it removes the need for the present Section 3 sanction. The present Section 3 sanction prohibiting acquisition of any new leases under the Mineral Leasing Act is too broad. The present scheme could lead to serious adverse repercussions in New Mexico's oil and gas industry. Should Congress choose not to embrace a proposal for mandatory rental payments, I recommend that Section 3 be amended and that the leasing prohibition of Section 3 be limited to the acquisition of new coal leases. This limitation is currently contained in all three bills before the Subcommittee.

Turnbacks are not a reasonable alternative for Section 3 violators. The goals of Section 3 are to prevent speculation on public lands and to promote development or relinquishment of pre-FCLAA leases. These remain worthy public land management objectives. However, allowing lease holders who are in violation of Section 3 to return non-producing leases in exchange for new leases as proposed in S.372, would promote completely antithetical goals. It would convert pre-FCLAA leases with unfavorable development prospects from liabilities, as they are under the current Section 3 provision, into assets to be "banked" by their lessees for future use as turnback candidates. Alternatively, such leases could to be sold in a lease speculation market to other companies for addition to their turnback portfolios.

In short, the turnback option would convert Section 3 into a boon rather than a burden to companies that were among the prime targets of the provision, namely, the holders of large numbers of undeveloped leases with poor development prospects. On the other hand, companies that have acted in good faith and relinquished their poor quality lease tracts in the face of the upcoming Section 3 deadline would be penalized for their actions.

Section 7 should be retained. As mentioned above, the ten year Section 7 diligence requirement in FCLAA should be retained in its present form. I concede the prospect of receiving a revenue flow from undeveloped post-FCLAA leases through advance royalty payments, as proposed in S.570 and S.372, is attractive.

However, automatic lease termination for non-producing leases followed by reissuance of those leases, with receipt of fair market value, is a better approach to public land management. Lease termination still ensures revenue-generating potential to the State through the bonus bidding process at competitive lease sales.

Although I oppose the advance royalty payment scheme as an alternative to lease termination under Section 7, I do not oppose the repeal of two other provisions of FCLAA that are related to diligence. The requirement that lessees submit mine plans within three years of lease issuance is needlessly meddlesome on top of the 10 year production deadline contained in Section 7. Furthermore, the requirement that all economically recoverable coal reserves on a lease tract be mined within a 40 year period goes too far in light of the "continuous operation" requirements contained in FCLAA.

Pre-FCLAA leases should be automatically adjusted to incorporate the provisions of FCLAA. Pre-FCLAA leases were nothing short of public land giveaways. The states received very little income from their issuance. The leases contained royalty payment requirements of less than $.20 per ton which is not an appropriate rate by current standards. The lease adjustment process, which occurs at 20 year intervals, provides the only opportunity for royalty payments to be set at appropriate levels. FCLAA sets 12.5% of market value as the proper royalty for surface-mined coal. That royalty rate is also appropriate for pre-FCLAA leases. Based on the average price of New Mexico coal in 1983, the 12.5% provision results in a royalty payment of about $2.20 per ton, or more than a 10-fold increase over pre-FCLAA royalty rates. At 1983 federal coal production levels, the higher royalties translate to more than $2 million in annual income to New Mexico.

Clearly, New Mexico has a strong interest in ensuring that pre-FCLAA lease terms are adjusted as quickly as possible. I therefore urge enactment of the provision in S.372 requiring the automatic readjustment of pre-FCLAA royalty rates to reflect the payment schedule set for new leases in FCLAA. I also oppose a provision in a bill recently voted out of a House Subcommittee that provides for a gradual phasing in of higher royalty rates over a number of years after readjustments. Such a provision would cost New Mexico millions of dollars while making only an insignificant contribution to lessening rate shock now suffered by electricity consumers in some parts of the country. Our calculations indicate that the higher royalties required by FCLAA would raise the cost of electricity delivered from a coal-burning power plant by less than 2% and that the impact on the total bill of an average residential customer, who receives power from a number of sources, will be much less.

In closing, I wish to again thank this Subcommittee for the opportunity to present my views on this issue which is of such significance to the State of New Mexico.

Senator Ford. Thank you, General. Since we have another General to my left, former General, he has some questions which I concur in, and I'm going to allow him to question you if that's all right.

Senator Bingaman.

Senator Bingaman. Thank you, Governor. Appreciate it. [Laughter.]

Senator Ford. God, I like that.

Senator Bingaman. Sounds pretty good, doesn't it?

Senator Ford. It sure does. At least you were in control.

Senator Bingaman. That's right. You could tell the General what to do in those days.

Senator Ford. Or where to go. [Laughter.]

Senator Bingaman. Let me get off of this and ask you something about the subject here. Let me just ask a question on this nonrecoupable fee. The Interior Department position is that we should go ahead and permit the holding of leases beyond the 10 years, and charge an annual holding fee which then will be recoupable if and when the lessee ever goes into production on the property.

Your view is that the recoupment is inappropriate and should not be an economic incentive that the Government adds in addition to whatever market incentives there are. Is that basically it?

Mr. Bardacke. Yes, Senator. The industry gets 10 years free, basically, now. I think that we should not force production just on the incentive of recouping a fee that was in fact paid for—what should be a nonrecoupable lease payment, some payment to the Federal Government and the State for the burden of having that nonproducing lease within its State boundaries.

By allowing the entire amount to be recouped, you might put a false reason for the company to go ahead and produce some 10, 20, 30 years later on, and that being just to recoup the fee from the outset.

Whether or not they produce coal within a State's borders or not should not have that incentive built into it, but should just have the question of the marketplace and the viability of the production of coal as its only and primary concern.

Senator Bingaman. Let me ask about this issue of the assignment of leases either during the 10 years or after the 10 years are up. It strikes me that one difficulty—I was trying to allude to this in my questions earlier—with the administration's proposal seems to be that it doesn't really leave the lessee with two options after the first 10 years, either to produce or to pay the fee; it leaves him with three options: produce, pay the fee, or assign the lease to somebody else who might have an interest in doing something.

I wonder what your position would be or what your thoughts are on the appropriateness of us continuing to permit the assignment of these leases indefinitely, regardless of what action the lessee has taken on the property.

Mr. Bardacke. I think, Senator, it's an excellent question and we face the same problem with the pre-FCLAA leases. As you know, as we approach August 1986, the time has run and they either have to relinquish or produce. Again, that is not the only option that they have had. For the last number of years a number of the companies, knowing that the deadline is running, have been assigning, and often times assigning to sister companies or partnerships, sometimes made up of the company that owned the original lease.

And so I think the idea of the diligence requirements of the 1976 amendment was to either require relinquishment of production, and I think assignment has created a problem because it's put off either of those alternatives. And I think that the assignment under post-1976 leases forever to avoid production or the payment of penalty is dangerous.

I don't know whether assignment should be limited altogether, or if after a period of time, perhaps 10 or 15 years, no assignment could take place, it either had to be relinquished or production take place, I really don't know the answer to that. But we've seen the problem of assignment with the pre-FCLAA leases and to allow assignment forever I think postpones either relinquishment or production, and that certainly is the goal of the diligence requirements.

Senator BINGAMAN. Am I correct that assignment starts the 10 years running again?

Mr. BARDACKE. That is my understanding.

Senator BINGAMAN. Then you're saying that the use of assignments has really given the companies an opportunity to avoid the diligence requirement that you believe Congress intended when they passed this provision.

Mr. BARDACKE. Certainly. And a number of the coal leases that are not produced, that were granted prior to 1976, have now been assigned in a way in which the 10 years has started to run again and companies have therefore put off the requirement to relinquish or produce.

Senator BINGAMAN. Let me ask you about your thoughts on the State's role in regard to this Federal Coal Leasing Program. Are there ways in which you believe that the States role could be improved or strengthened and the State could have a more reasonable input into what's done with Federal leases within its borders?

Mr. BARDACKE. Senator, the Mineral Land Leasing Act recognizes a partnership between the State and Federal Government, in that the State is entitled to 50 percent of the gross proceeds under the Mineral Land Leasing Act.

I think we got none of the benefits of that partnership in the pre-1976 leases. In other words, there were no economic impact studies required. There was no environmental planning, and the State had little or no voice in where the lands were leased.

You asked in your opening remarks, New Mexico has seen very little development of its Federal coal reserves. I think that what happened is that the Federal Government leased much too much land too early. Most of it was leased in the San Juan Basin where there are inherent obstacles in that there's no transportation for the coal out of the San Juan Basin, and that in fact the coal market is somewhat soft.

In spite of that, the industry in New Mexico has doubled over the last decade. But I believe that in the post-1976 leases, the State has been involved in the partnership to a much greater extent. I think the State is now involved in economic planning as well as environmental planning. So that the burdens that we were left with in the pre-1976 leasing have been lessened to a great extent in the post-1976 programs developed by the Federal Government.

I think that, of course, the partnership can always be better. The State can be involved in a much greater extent in the environmental and economic planning of the Federal Government in its leasing program, but I think the situation has gotten much better.

Senator **Bingaman**. Let me ask on another issue which you may or may not want to address, this question of 2(c) of the Mineral Leasing Act. Do you have a position on that or comments that you'd want to give us?

Mr. **Bardacke**. You're right, Senator; I do not want to address that issue.

Senator **Bingaman**. OK, that's what I thought. Just checking.

Mr. Chairman, did you have some questions here?

Senator **Ford**. No, I have no questions. I am yielding you my time.

Senator **Bingaman**. I think that covers the main points I wanted to ask about. Thank you very much.

Senator **Ford**. General, you're mighty nice and we appreciate your coming and testifying today and we'll look forward to reading your whole testimony.

Senator **Bingaman**. Mr. Chairman, let me just say that General Bardacke does a great job out there as our Attorney General, and I'm proud to have him as my successor in that August position.

Mr. **Bardacke**. Thank you very much.

Senator **Ford**. I can't do anything but agree with him.

We have, I think, eight witnesses now: Messrs. Holsten, Winterer, Mahaffey, Ewing, Brown, Zitting, Wilson, and Thompson.

[Pause.]

Senator **Ford**. Could I ask the eight gentlemen a question? Have you all ever gotten together like this before?

Mr. **Holsten**. Only over drinks. [Laughter.]

Senator **Ford**. Mr. Holsten, I understand you're going to be speaking basically for the coal producers, and that each of those for the railroads will be speaking on their own. If you'll just pull that microphone up, unless you have other statements that are to be made here today. It will be included in the record, if you want to summarize, it will be fine.

I do have some questions for all of you, and will address my questions to you and I guess then to Mr. Wilson, Mr. Thompson, Mr. Zitting, individually. So you may proceed.

STATEMENT OF RICHARD HOLSTEN, CHAIRMAN AND PRESIDENT, PITTSBURG & MIDWAY COAL MINING CO.

Mr. **Holsten**. First I want to express on behalf of my associates our appreciation of the opportunity to come before you this morning on a matter that's of great urgency, not just to us but to all holders of the Federal coal leases, and comment that it's a pleasure to sit alongside our friends and fellow miners representing the railroads.

I'm Dick Holsten. I'm chairman of the National Coal Association this year. I'm chairman and president of the Pittsburg & Midway Coal Mining Co. of Denver. Mr. Brown is chairman and CEO of

Consolidation Coal Co. Mr. Ewing is president of the Peabody Development Co. Mr. Mahaffey is president of the Shell Mining Co. And Mr. Winterer is the senior mining officer of Utah International.

Together, I think, we represent a very major portion of the Federal lessees in the country. We have mining interests in all of the western coal States. We are testifying on behalf of the three trade associations and, of course, our own interests. Each one of us has to deal regularly with the railroads, many of which have monopoly power over our transportation and, therefore, we know from experience, spanning many, many years what the problems and concerns are of captive shippers.

In the time allotted to us we want to describe what we see as the unrealistic, unreasonable, unforeseen, and unnecessary aspects of the Federal Coal Leasing Amendments Act of 1976 and comment on the bills pending before the committee.

Before asking my associates to comment on the leasing issues which are the subject of this morning's hearings, I'd like very briefly to address the 2(c) issue. We have prepared a rather detailed and voluminous and formal statement in which, together on the comments on the leasing issues, we outline our basic concerns with 2(c), the rationale for our positions, a constructive critique of the 2(c) amendments before the committee, and we offer a conceptual framework within which we believe the 2(c) can be modified.

I'm not going to attempt to rehash all that. I have four or five points that I'd like to make that are pertinent to the industry's position on 2(c).

First, I need to clarify the earlier statement that we are speaking on behalf of the three trade groups. Obviously, since the membership in these organizations also includes the mineral affiliates of the railroads, the views that I'm going to express don't necessarily represent the views of the entire membership of the organizations. They are, however, the goals and the programs of National Coal and MARC.

I've heard it said that the real reason that the coal industry is opposed to any repeal of 2(c) is because we don't want and we don't need additional competition in an overcrowded industry. That charge is just plain flatout wrong.

There are literally thousands and thousands of coal operators today, as you well know, and there is constant entry into and departure from the industry occurring at all times. If a railroad really wants to get into the coal business, we would welcome the financial strength and technological expertise that it could bring to a highly unstructured and highly competitive industry.

So within that context that we're not trying to keep anybody out of the business, the coal industry does agree that some modification to 2(c) should be considered. Specifically, we would not oppose an amendment that would allow a railroad either directly or through its mineral affiliate to hold Federal coal leases outside of its exclusive rail service area.

The point is that it's not the threat of competition that bothers us; it's the type of competition, through potential for unfair and discriminatory competition that would exist were a railroad with monopoly power over transportation allowed to produce and then to transport and market its own coal in direct competition with a company that is on its rail line and captive to that railroad.

There's a distinction here when we talk about competition. We're not talking about interfuel competition, coal versus oil or gas or nuclear. We're not talking about regional competition—Utah coals versus Wyoming coals, or Wyoming coals versus Montana coals.

What concerns us is the very precise, distinct competition between coal produced by a railroad's own mining affiliate and coal from another producer who must rely solely on that railroad to get his coal into market. There's a very basic conflict of interest here, and this is exactly the problem we face with our three major western coal-hauling railroads should 2(c) be repealed.

The second point I want to make is that any consideration to modify 2(c) must address more than just the leasing issues. Appropriate changes in existing Federal coal leasing procedures would be fairly simple and fairly easy to make, once the more complex problems in the areas of transportation and antitrust are resolved.

Certainly the ratemaking flexibility afforded the railroads under Staggers has only heightened our concerns over their ability to engage in overt or subtle discrimination in ratemaking, in the providing of service, and in the marketing of their product. Without adequate competition, there then has to be adequate protection and recourse in these areas, and this must be part of any thorough consideration by Congress.

The sole purpose of 2(c) when it was enacted some 65 years ago was to protect coal producers from the abusive power of the railroads. That objective is still valid today, and any consideration of 2(c) must involve all aspects of the problem, including but not merely limited to the leasing issues.

The third point evolves from the second. Modification of 2(c) is a broad and multifacted issue that's going to take time to resolve. And yet there is an immediate and very pressing need to correct the leasing inequities that now exist and that are totally unrelated to 2(c). These will be discussed by my colleagues next, but we all have to recognize that there is simply not enough time to resolve the very complex 2(c) issues within the very, very few months we have remaining before the diligent development deadlines that were established by the 1976 act force precipitous, illogical, and in some cases stupid actions on the part of the Federal lessees.

For many companies time has already run out and certainly each day closer we get to August 4, the less flexibility we have in resolving these dilemmas that were created by the 1976 act. If 2(c) is to remain linked to needed correction in the 1976 act, this may effectively scuttle any hope for timely relief on our leasing problems.

The fourth part I want to make—and I'm not at all sure why this is an issue at all—is that there has been and there continues to be ongoing good faith dialog between the coal industry and the mineral affiliates in an attempt to legislatively resolve our mutual concerns. Together, we've discussed the issues, we've explained our concerns, we've critiqued their proposals, and progress has been made in the leasing area. There's been no stonewalling, there's been no reluctance to meet.

However, we have now reached the point where we need to discuss the transportation and the antitrust issues, topics that are beyond the normal corporate responsibilities of a minerals affiliate. We've requested an opportunity to meet with railroad management. We want to outline our basic concerns in these areas and, jointly with them, seek possible legislative solutions.

However, to date, any request for such a meeting has been denied us.

And finally, we recognize that the railroads control vast amounts of coal in the checkerboard areas, and that these reserves should be brought into production in a timely and orderly manner. There are ways to accomplish this, while at the same time providing adequate safeguards against potential abuse.

In our written statement which we would file for the record, we have suggested one way in which this could be accomplished through a cooperative leasing program.

Mr. Chairman, we need to settle the 2(c) issue, but even more critical from a time standpoint, we need to correct the leasing inequities created by the 1976 act. I would respectfully urge the committee to deal separately with the two issues.

Senator FORD. Mr. Holsten, would you indulge me just a moment? You're beginning—there are two basic arenas here today, and you've just gone beyond 2(c) now, getting into some others. I wonder if you might just stop here and let both sides here discuss 2(c) and then move to the second phase.

Would you indulge me that?

Mr. HOLSTEN. Of course, sir.

Senator FORD. What about the other gentlemen now to your right? Do they have something they would like to add to your 2(c) portion of your statement? Or are you speaking for them?

Mr. HOLSTEN. I am speaking for them relative to 2(c); yes, sir. They will talk the leasing issues.

Senator FORD. Then I will have questions for both groups as it relates to that, but then the other three gentlemen, I'll be glad to listen to you if you want to come back and maybe refute or give your position. I see one or two of you on the edge of the chair, based on the statement that's been made by Mr. Holsten, and, I thought, maybe it might be a good time to just kind of let you have your say, rather than sit there and boil.

Mr. Zitting, do you wish to make a statement as it relates to 2(c)?

STATEMENT OF RICHARD T. ZITTING, PRESIDENT, SF MINERALS CORP.

Mr. ZITTING. Yes, thank you, Mr. Chairman. My name is Richard T. Zitting and I'm president of SF Minerals Corp. of Albuquerque, NM. I'm here today to urge the repeal or substantial modification of section 2(c) of the Mineral Leasing Act of 1920 which prohibits a company operating a common carrier railroad from holding a Federal coal lease.

SF Minerals, along with wholly-owned subsidiary companies compromises the hard minerals or mining arm of the Santa Fe Southern Pacific family of companies. We are a coal-producing company. To some of our competitors in the coal industry, however, we are considered second-class citizens because of our affiliation with the common carrier railroad. This is because my company's stock is owned by a company who also happens to own the stock of the Atchison, Topeka & Santa Fe Railway Co.

However, in fact, SF Minerals is a self-contained corporate entity. We earn our own money. We pay dividends to our holding company stockholder, and we conduct mineral exploration, development, production and marketing operations at a wide variety of locations throughout the Western United States.

We do not operate a common carrier railroad. The only product we produce which moves by common carrier railroad is coal from our Lee Ranch Mine in New Mexico and in that case we load our coal into our customer's cars at the mine, and the customer has his own separate arrangement with the railroad to haul the coal to the powerplant, for which service he pays the railroad directly.

Under the usual arrangement throughout at least the western coal industry, a coal mining company, whether it happens to be associated with the railroad or not, delivers the coal to the utility customer f.o.b. the loadout facility at the mine, and the customer generally makes it own separate freight deal with the railroad.

The utility customer does this by choice, as he feels that he can best control his transportation costs by dealing directly with the railroad involved.

Other companies in the Santa Fe Pacific family that could also be classified as rail-affiliated companies include its oil and gas, forest products, pipeline, real estate, construction and financial services companies. The presence of these vigorous companies would bristle as I do at any suggestion that the nonrail companies are somehow subordinate to or subject to special favors of the Santa Fe Railway.

Yet, many of our competitors in the coal industry continue who argue that SF Minerals, because of its affiliation, must be denied the right to fully participate in the coal industry without the right to compete for Federal coal leases, our horizons are necessarily limited because of the dominant position of the U.S. Government in western coal reserves.

Among the SF Minerals group of mining companies in Albuquerque is SF Coal Corp., which is the company that conducts the actual coal production. That company is staffed with some 170 permanent and full-time coal miners, engineers, and the like whose sole occupation is producing coal.

That company's Lee Ranch Mine began coal production 1 year ago from a mining unit comprised of privately-owned fee coal and State of New Mexico coal that we purchased through a competitive lease sale.

Commencement of production was the culmination of a 5-year program of coal exploration, environmental studies, mine permitting, marketing and construction. Construction consisted of building the mine and coal handling facilities as well as a private rail spur, the majority of which is owned through a limited partnership arrangement by our customers. None of that spur is owned by the Santa Fe Railway.

This year, SF Coal will sell over 2 million tons of coal to our customer's plants in New Mexico and Arizona. This major western surface mine which represents a $100 million investment was designed to mine only fee and State coal, despite the presence of several sections of unleased Federal coal within and adjacent to the mining unit.

The resulting mine plan which requires SF Coal Corp. to mine alternate sections and leave buffers of coal along the section lines certainly does not maximize utilization of the resource, nor does it minimize operating costs or environmental disturbance. Yet, it has the legacy of section 2(c).

The Lee Ranch Mine takes a back seat to no one as a modern, efficient, and well-run operation that is a model of environmental protection, productivity, and employee safety. We compete head to head with a number of other mining companies in New Mexico and indeed throughout the West for our coal sales.

We obtained the business we have by offering the lowest cost reliable supply available to the customer at the time the contracts were awarded. I maintain that these facts qualify us as a full-fledged member of the coal-producing industry. We certainly should not be prevented from competing freely by the continued application of an interpretation of section 2(c) of the Mineral Leasing Act which has long since become obsolete and inappropriate and which continues to deny us the same rights to obtain leases on Federal coal as are afforded to other members of this industry.

And I believe that's about all the time I should take. I've submitted a written statement that outlines in some detail the problems we've had in trying to operate under 2(c). I'm at great pains, though, to make one point here today; that there are no railroads represented at this table; that there are only mining companies. This is a mining company panel, and that we are not a railroad trying to get in the mining business; we are a mining company already in the mining business, and we're asking that we be treated fairly as the rest of the mining companies at this table.

Senator FORD. We all understand a wholly-owned subsidiary.

Mr. ZITTING. We're not a subsidiary of a railroad, though.

[The prepared statement of Mr. Zitting follows:]

Statement of Richard T. Zitting, President, SF Minerals Corp.

Mr. Chairman, my name is Richard T. Zitting. I am president of SF Minerals Corporation of Albuquerque, New Mexico. I am here today to urge repeal or substantial modification of Section 2(c) of the Mineral Leasing Act of 1920 which prohibits a company operating a common carrier railroad from holding federal coal leases.

SF Minerals, along with several wholly-owned subsidiary companies, comprises the hard minerals group or mining arm of the Santa Fe Southern Pacific family of companies. To some of our competitors in the coal industry, however, we are considered second-class citizens because of our affiliation with a common carrier railroad. This is because my company's stock is wholly owned by the same company that owns the stock of The Atchison, Topeka and Santa Fe Railway Company.

However, SF Minerals is a self-contained corporate entity. We earn our own money; we pay dividends to our sole holding company stockholder, and we conduct mineral exploration, development, mining and marketing operations at a wide variety of locations in the western United States.

We do not operate a common carrier railroad. The only product that we produce which moves by common carrier railroad is coal from our Lee Ranch Mine in New Mexico, and in that case we load our coal into our customer's cars at the mine and the customer has its own separate arrangement with the railroad to haul coal to the power plant, for which service the customer pays the railroad directly. Under the usual arrangement throughout at least the western coal industry, a coal mining company, whether it happens to have some affiliation with a railroad or not, normally delivers the coal to the utility customer F.O.B. the loadout facility at the mine and the customer makes its own separate freight deal with the railroad. The utility customer does this by choice as it feels it can best control its transportation costs by dealing directly with the railroad involved.

Other so-called "rail-affiliated" companies in the Santa Fe Southern Pacific family include its oil and gas, forest products, pipeline, real estate, construction, and financial services companies. The presidents of these vigorous companies would bristle, as do I, at any suggestion that the non-rail companies are somehow subordinate to or subject to special favors from Santa Fe Railway. Yet many of our competitors in the coal industry continue to argue that SF Minerals -- because of its corporate affiliation -- must be denied the right to fully participate in the coal industry. Without the right to compete for federal coal leases, our horizons are necessarily limited because of the dominant position the United States holds in western coal reserves.

Among the SF Minerals group of mining companies in Albuquerque is SF Coal Corporation, which is the company that conducts our actual coal production operations. It is staffed with some 170 permanent, full-time coal miners, engineers and the like whose sole occupation is producing coal for delivery to our coal customers. That company's Lee Ranch Mine began coal production one year ago from a mining unit comprised of privately owned fee coal and State of New Mexico coal obtained through a competitive lease sale. Commencement of production was the culmination of a five-year program of coal exploration, environmental studies, mine permitting, marketing, and construction. Construction consisted of building the mine and coal handling facilities as well as a 27-mile long private rail spur, the majority of which is owned by our customers through a limited partnership arrangement and leased to SF

Coal Corporation. This year SF Coal will sell over 2 million tons of coal to our customers' power plants in New Mexico and eastern Arizona.

This major western surface mine, which represents over a $100 million investment, was designed to mine only fee and state lease coal despite the presence of several sections of unleased federal coal within and adjacent to the permit area. The resulting mine plan, which requires SF Coal Corporation to mine alternate sections and leave buffers of coal along section lines, certainly does not maximize utilization of the resource, nor does it minimize operating costs or environmental disturbance. Yet it is the legacy of Section 2(c).

The Lee Ranch Mine takes a back seat to no one as a modern, efficient and well-run operation that is a model of environmental protection, productivity, and employee safety. We compete head to head with a number of other mining companies in New Mexico, and indeed throughout the West, for our coal sales. We have obtained the business we have by offering the lowest cost, reliable supply available to the customer at the time the contracts were awarded. I maintain that these facts qualify us as a full-fledged member of the coal producing industry. We certainly should not be prevented from competing freely by the continued application of an interpretation of Section 2(c) of the Mineral Leasing Act which has long since become obsolete and inappropriate and which continues to deny us the same rights to obtain leases on federal coal as are provided to the other members of this industry.

Now let me take a few minutes to explain how our efforts have been and continue to be impeded by Section 2(c).

About a dozen years ago our mining companies decided to become a more active force in developing their coal and other mineral resources in the Southwest. Historically, we had followed a more or less custodial role in developing our resources, leasing them out for development by other companies. In the early 1970's, in the course of considering a variety of approaches to develop our coal, we considered the possibility of joint arrangements with other coal companies which held federal coal leases in a checkerboard pattern with our fee coal in New Mexico. It was then that the constraints of Section 2(c) first impacted on us, because a number of our possible joint venture proposals would have given us security interests in the assets of our partners, including their federal coal leases, which appeared to be prohibited by a broad reading of Section 2(c). Since the coal leasing legislation that was eventually enacted in 1976 was then pending before the Congress, and inasmuch as the Public Land Law Review Commission ("PLLRC") had recently recommended repeal of Section 2(c), we decided to seek an amendment to that legislation which would repeal Section 2(c). We presented our proposal to Senator Metcalf, whose subcommittee of the predecessor of this Committee was considering the coal leasing bills. Senator Metcalf endorsed it, cleared it with Committee Chairman Jackson (who had been a member of the PLLRC), the full committee reported out the coal leasing bill with our amendment, and it was passed by the Senate.

When the House version of the coal leasing bill reached the full House Interior Committee, an amendment to repeal 2(c), which had the support of the Interior Department and contained conditions against discriminatory treatment in favor of rail coal affiliates, lost on an 18-18 tie vote.

Representative Mink, who was in charge of the bill, voted seven proxies against the amendment because she had not been able to fully inform herself about possible consequences of permitting railroads or their affiliates to hold federal coal leases. The House bill was later passed without a 2(c) repealer, and the issue was scheduled to be resolved in conference with the Senate.

During that period Representative Mink conducted oversight hearings on the 2(c) issue and we made a variety of proposals designed to satisfy her concerns. Just as we appeared to be nearing some common ground, with the support of the Justice and Interior Departments, the Senate abruptly decided to accept the House coal leasing bill, so that the opportunity to reach agreement on some kind of conditional repeal or modification of 2(c) in conference disappeared.

That was 1975. The Interior Department's Solicitor later rendered an opinion holding that railroad coal affiliates would be entitled to hold federal coal leases if they were truly independent coal companies and not the "alter ego" of their sister railroads. In light of that decision we began to plan for nominating and bidding on federal coal leases in New Mexico in which we were interested. We also took assignments of some small federal coal leases in the Raton area of New Mexico. Interior found that we were qualified to hold these leases under Section 2(c) and that we were not the "alter ego" of Santa Fe Railway. We also passed the Justice Department's antitrust review under Section 15 of the Federal Coal Leasing Amendments Act of 1976 with no difficulty. However, the Justice Department, which disagreed with Interior's interpretation that 2(c) permitted rail affiliates to hold leases, threatened not to defend Interior if that decision were challenged by some of our competitors, who were actively seeking Secretary Watt's support in opposition to permitting rail-affiliated coal companies from holding federal leases under Section 2(c). Consequently, Interior backed down and in December of 1982 Solicitor Coldiron reversed the prior Solicitor's ruling and declared rail coal affiliates ineligible to hold federal coal leases in the future, grandfathering those leases which had been issued.

Having been denied access again to federal coal because of the reinterpretation of Section 2(c), we welcomed the creation of the Linowes Commission to review certain aspects of the federal coal leasing program. We presented detailed statements to the Commission outlining the reasons why we felt, along with the Public Land Law Review Commission and the Justice and Interior Departments in both Democratic and Republican administrations over the past 15 years, that repeal of 2(c) would be in the public interest. We also rebutted the arguments which our coal company competitors had advanced over that period to deny us access to federal coal leases. I have attached copies of those statements to my testimony which I would like included in the record.

The Linowes Commission recommended conditional repeal of Section 2(c) in 1984. Senator McClure subsequently urged both sides to the 2(c) issue to try to reach some compromise agreement. Based on the Linowes Commission recommendation, we joined efforts with Rocky Mountain Energy Company and Meridian Land & Minerals Company to develop a compromise proposal to respond to all the arguments that our competitors in the industry had historically advanced. Mr. Wilson of Rocky Mountain Energy Company will outline the elements of our proposal and our unsuccessful efforts to reach an accord with these members of the industry who apparently remain opposed to our access to federal coal. I should note that it appears that at least a number of the largest, most powerful companies have decided not to continue negotiations, although we understand that the industry is split over that hardline strategy.

The Linowes Commission correctly recognized that 2(c) unfairly restricts competition for federal coal leases by companies such as SF Coal Corporation, and therefore reduces federal revenues and inhibits competition aimed at producing the lowest cost coal for the consumers. Although we believe the facts justify a straight repeal of Section 2(c), we have gone the extra mile to try to allay the fears of our coal competitors about our holding federal coal leases.

I believe you will find that we have made an honest effort to reach a reasonable compromise that is in accordance with the findings of the Linowes Commission.

Thank you for the opportunity to appear today.

Senator **Ford**. All right.
Mr. Thompson.

STATEMENT OF G.W. THOMPSON, PRESIDENT, MERIDIAN MINERALS CO.

Mr. **Thompson**. Thank you, Mr. Chairman. My name is Bill Thompson. I'm the president of Meridian Minerals Co., a minerals mining and management subsidiary of Burlington Northern, Inc.

The purpose of my testimony is to urge repeal or modification of section 2(c) of the 1920 Mineral Leasing Act which prohibits railroads from owning Federal coal leases. In the spirit of compromise, the three railroad affiliated coal companies represented here today have offered an amendment to section 2(c) in lieu of its outright repeal.

We are grateful that both this amendment and a full repeal amendment have been introduced by the distinguished chairman of this committee.

Section 2(c) repeal is not special interest legislation without public benefit. The Linowes Commission and the Departments of Justice and Interior, the Public Land Law Review Commission, and the last five administrations have all supported repeal of section 2(c) because it would be in the public interest.

The status quo in the checkerboard areas has resulted in inferior management, frustrated timely development, and deflated the value of Federal coal. Over the last three decades, 16 percent of the Federal coal and 40 percent of Meridian's coal in the checkerboard were leased, but only 13 percent of the coal produced in the Powder River and Fort Union regions where the checkerboard is located comes from these leases, a production record which neither we nor the Federal Government can take pride in.

The Federal Government not only loses royalty revenues from idle checkerboard leases; it also loses sale revenues because the winning bidders discount their bid to reflect the uncertainties created by the checkerboard ownership pattern. This was demonstrated in the 1982 Powder River and the 1983 Fort Union leased sales where the bonus bids on the checkerboard were much lower than the bonus bids on consolidated lease tracts.

The industry position that we should be content simply to lease our coal to them and forego any effort to develop our own resource is particularly galling. Meridian has leased approximately 4.2 billion tons of coal in Montana and North Dakota and witnessed a total 1984 production of approximately 8 million tons of Meridian coal.

This constitutes a production rate of two one-thousandths of our leased reserves a year from leases which are close to or already are 20 years old. Can you blame us for being dissatisfied and wanting to take a more active role in developing our resources?

Industry claims that if we are allowed to bid on Federal coal, we would quickly create a monopoly or anticompetitive situation because of the size of our coal holdings. This is absurd. Unlike our competitors' reserves, our coal was randomly acquired and is much less attractive than coal elsewhere in the Powder River region. The best coal we own is already under lease well into the next century to other coal companies.

In addition, the leasing laws and rules limit the amount of Federal coal we can acquire, and we have offered to accept a limit of one-half the current State acreage limitation for our entire multistate checkerboard area.

The industry claims our checkerboard holdings give us an unfair advantage in obtaining the intervening Federal coal. There is clearly a double standard at work here. It is common coal industry practice to gain an edge in bidding on Federal coal through the acquisition of adjacent private coal rights and overlying surface rights. I don't hear our industry opponents offering to put these coal rights up for cooperative leasing or to disclose all the date they obtain from their adjacent leases, requirements which the Linowes Commission recommended and we have agreed to for our coal in the checkerboard.

Obviously, the industry is not trying to prevent unfair competition. They are just attempting to prevent more effective competition for both Federal coal reserves and coal supply contracts.

We sincerely believe that our opponents' arguments against repeal are unpersuasive and indeed may be embarrassing when applied to their own legislative agenda. Our opponents claim section 2(c) should not be repealed because little has changed in the 65 years since it was enacted.

Then, in virtually the same breath, they support their effort to repeal two lease restrictions, section 3 and 7 which apply to them, by asserting that circumstances have changed dramatically in the brief 9-year period since those provisions were enacted. They claim that the section 3 and 7 restrictions are no longer needed to serve the purpose for which they were written. They are redundant to other provisions which properly serve that purpose, are too punitive, inhibit coal competition, unfairly discriminate against certain competitors and, for all those reasons, are no longer in the public interest.

But they conveniently forgot that these very same reasons were given by the Justice Department and the Linowes Commission for the repeal or amendment of section 2(c). We believe that a comprehensive review of all leasing restrictions, section 2(c), 3 and 7, will show that all need to be modified, if not repealed, and for identical, equally valid reasons, we urge a complete package of reforms in the law governing Federal leasing.

Thank you.

[The prepared statement of Mr. Thompson follows:]

STATEMENT OF G.W. THOMPSON, PRESIDENT, MERIDIAN MINERALS CO.

My name is Bill Thompson. I am the President of Meridian Minerals Company. Meridian is the minerals mining and management subsidiary of Burlington Northern Incorporated. Among the company's duties is management of the coal reserves remaining in Burlington Northern ownership from the original Northern Pacific land grant.

The purpose of my testimony is to urge repeal or modification of section 2(c) of the Mineral Leasing Act of 1920 which prohibits railroads from owning federal coal leases. For most of section 2(c)'s life, government attorneys consistently found that the provision did not preclude Meridian and its predecessors from leasing federal coal. However, in recent opinions by the Departments of Justice and the Interior, the leasing prohibition was extended to us, not because we are a railroad company, but because we are affilated with a railroad company -- the Burlington Northern Railroad. Having reached this legal conclusion, but also believing that section 2(c) is no longer in the public interest and its extension to railroad coal affiliates would only magnify its harmful effects, the two Departments have strongly advocated the provision's repeal. Indeed, repeal has been the official position of the last four Administrations. And most recently, the Congressionally - established Linowes Commission advocated amending section 2(c) to eliminate the leasing ban.

Jim Wilson will provide a detailed statement of the reasons why section 2(c) is no longer appropriate public policy and a description of an amendment to section 2(c) offered by the three railroad-affiliated coal companies represented here today as a compromise in lieu of the provision's outright repeal. We are grateful that both this amendment and a full repeal amendment have been introduced by the distinguished chairman of this committee (Amendments No. 801 and 802, Senator McClure).

I would like to address three subjects which are of particular concern to me personally and to my company. Whenever I listen to those members of the coal industry who oppose any change in section 2(c), I am particularly confounded by three of their arguments:

o their effort to paint section 2(c) repeal as special interest legislation without public benefit;

o their suggestion that a railroad-affiliated coal company should be content to simply lease its coal to them and forego any effort to develop its resource itself; and

o their insistence that any effort by a railroad-affiliated coal company to develop its own coal would quickly create a monopoly or anticompetitive situation because of the sheer size of its coal holdings.

Spurious as these arguments are, they compel a response.

If past testimony by our industry critics is any gauge, I'm sure the impression left by today's statements from those who oppose section 2(c) repeal will be that the fragmented federal and private coal ownership pattern in the so-called checkerboard areas resulting from 19th century railroad land grants does not present any significant management problems and does not reduce the likelihood of the resource's development or the amounts paid for it. To the contrary, both the Federal government and the railroad coal affiliates have learned the hard way that the status quo in checkerboard areas does lead to unavoidably inferior management, frustrate timely development, and deflate the value of both the public and private coal.

In the past, the federal government and Meridian have sought to little avail to develop their checkerboard resources separately. The checkerboard which includes Meridian's coal is situated in the Powder River and Fort Union coal regions. Over the last three decades, 15% of the federal coal and 47% of Meridian's coal in the checkerboard in these two regions were leased to various companies. Yet, despite this effort to commit checkerboard coal to production, less than 13% of the coal produced in these two regions is federal and Meridian checkerboard coal. Neither the federal government nor Meridian can take pride in this result. While there may be several reasons why Meridian and the federal government have been unable to capture their fair shares of the two regions' coal production from the checkerboard, the Interior and Justice Departments, the Linowes Commission, and we believe that the problems associated with assembling and marketing coal from unconsolidated checkerboard properties have been a decisive factor.

Without production from the checkerboard, royalties are lost on both federal and Meridian-leased coal. But the checkerboard coal ownership patterns decrease the value of private and federal coal beyond the reduced royalties stream. Bidders for either our coal or the federal coal in the checkerboard are unwilling to pay as much as they would for coal already blocked into a mining unit.

They will discount their bonus bids to reflect the risk and uncertainly they run in bidding on an unassembled property. Or, if they have already leased the intervening coal, their bonus bids will be discounted in the knowledge that they will have frozen out potential competitors. The most recent evidence of this is the 1982 Powder River lease sale in which federal tracts in the checkerboard received lower bonus bids than blocked-up federal tracts outside of the checkerboard.

This woeful record of coal production and deflated coal values in the checkerboard is convincing evidence of the ineluctable management problems presented by fragmented checkerboard coal ownership. More than a single company is harmed by the inability to manage effectively unconsolidated coal resources in the checkerboard. When the checkerboard coal is sold at reduced prices and lies idle thereafter, the resource owners -- the federal government, taxpayers, and Meridian -- lose sale and production revenues; the state and local governments lose their statutory share of those same revenues and their own tax revenues from Meridian and the coal producers; coal buyers and utility customers lose the price-lowering influence of additional coal marketing competition; and the local communities and residents lose the significant business and employment opportunities generated by the resource's production. Most decidedly, amending section 2(c) benefits many, not a select few; is in the public interest; and cannot be fairly painted as simply a special interest initiative.

I will now shift gears and talk about Meridian's own problems in attempting to manage the checkerboard: why we are not satisfied (indeed why no company could be satisfied) with the return we are receiving on our largest asset -- our coal, and how section 2(c) prevents us from improving that return significantly.

When Meridian Minerals Company was established four years ago, the new company adopted as a principal mission the rationalization of its checkerboard coal holdings to avoid the management problems which have frustrated checkerboard coal production. The best method of rationalizing checkerboard coal holdings is to consolidate them -- a step we were unable to take for the 76% of our subbituminous and 21% of our lignite we had already leased by 1981. All we could do for our previously leased coal was to facilite its marketing and production by assisting our lessees to match their leases more closely with their surface and other private holdings. To accomplish this, we entered into lease renegotiations with several of our lessees and signed four new long-term leases covering 970 million tons of some of our best coal in the Tongue River Basin. For the same purpose, we sold outright 215 million tons of leased coal to the lessee, Peabody Coal Company.

Our remaining unleased coal presented our only present opportunity to consolidate private and federal checkerboard coal holdings. Both Meridian and the federal government recognize that the most effective, least costly means of achieving that objective is to permit railroad coal affiliates to acquire federal coal leases. As section 2(c) withholds that authority, few effective options remain open to us: in the only two notable actions involving our unleased coal, we and the Bureau of Land Management have agreed to study jointly the Timber Creek deposit in McCone County, Montana, for cooperative leasing and have concluded one coal exchange on the nearby Circle West deposit.

Despite all these efforts, however, the reality is discouraging. Meridian has leased approximately 4.2 billion tons of coal in Montana and North Dakota and witnessed a total 1984 production of approximately 8 million tons of Meridan coal. This constitutes a production rate of less than two thousandths of our leased reserves a year or six ten-thousandths of our total reserves -- a production rate that is intolerable by any measurement. Nor is production occuring as a result of our efforts with our unleased coal -- we are no closer today to a cooperative lease sale and our sole exchange is under challenge in court. We know the best way to increase production is to actively manage our reserves, but section 2(c) stands in our way.

A number of our potential competitors do not care to have us better able to manage our reserves if it means -- as it must -- our leasing of the intervening federal coal. They allege that the railroad-affiliated coal companies would have an unfair advantage in bidding on federal coal leases in the checkerboard. Two reasons are often given to explain this advantage:

o Meridian would have superior knowledge on which to base its bids on the intervening federal coal because of the information it has already obtained on its own coal; and

o Meridian could stifle leasing competition by withholding or threatening to withhold its coal from lease to the winning bidder for the intervening federal coal if Meridian is not the winning bidder.

You will hear Mr. Wilson describe our suggested amendment provisions to ensure that these alleged competitive problems do not occur. What I am sure you will not hear today is other coal industry spokesmen volunteering that, as our lessees, they have inherited the same advantage we are said to have. As I mentioned earlier, our fourteen lessees control 4.2 billion tons of our coal. Several of these lessees are among the largest coal producers in the United States. They will control the development rights to our coal for the foreseeable future as most of these leases do not expire until well into the next century. Our lessees, too, have collected information on our coal in their leaseholds and are also free to withhold their leases of our coal from the winning bidders for the intervening federal coal if other than themselves. In fact, they are in a position to play us off against the government pressuring for what they want since neither we nor the government is free to make effective management decisions while they control our coal.

Why are they so vocal about our potential advantage but so silent about theirs? If you study the expressions of interest and winning bids in recent federal coal lease sales, you will readily see that in most cases those who submitted the expressions and made the bids had gained control of as much adjacent non-federal coal and overlying surface rights as they could to discourage competing bidders. Their success can be seen by the high percentage of single bidders in those lease sales. Though it's a common industry practice to gain an edge in bidding on federal coal through the ownership of adjacent and overlying coal and surface rights, the industry condemns it only when it is to be used by other, potentially new entrants - namely, the railroad-affiliated coal companies. Our section 2(c) opponents construct a blatant, double standard when they present the practice as unique to railroad coal affiliates.

As most of the private rights available in the best coal areas have already been purchased by one large coal company or another, only a new major player having a substantial stake in developing a given deposit is in a position to bid against these entrenched parties. Within the Powder River/Fort Union checkerboard that new party could be Meridian. We would not let a surface or non-federal mineral position discourage us from bidding if we felt we had the best chance to develop a property containing substantial quantities of our own coal. This is why we believe the Linowes Commission and the Justice Department recognized that the entry of the railroad-affiliated coal companies into the federal lease market might be the best if not the only way to increase competition in the checkerboard areas.

This brings me to the last of my three points: even were we to obtain the right to bid on federal coal in the checkerboard our course would not be easy and any suggestion that we could become a dominant, even oppressive, force in the western coal industry is apocryphal. Our opponents paint appalling pictures of a massive Meridian coal grab and domination of coal production if we are permitted to lease within our checkerboard simply because of the sheer size of our coal holdings. They seem always to point to us first as the largest reserve holder of the three railroad-affiliated coal companies. They seldom miss the opportunity to mention that we own 13 billion tons of coal -- 6.5 billion tons of subbituminous coal in the Powder River region and a similar amount of lignite in the Fort Union region. What they fail to mention is that these holdings differ dramatically from competing coal in quality and minability and cannot be equated with coal held in producing companies' reserve bases. Despite their size, our holdings present us with a very limited number of opportunities to compete for a few federal coal leases within the checkerboard.

First, it is worth recalling that the coal reserves Meridian inherited from the railroad land grants were clearly not selected for their production potential. In general, Meridian's coal is of poorer quality than other reserves in the Northern Plains. Over half of Meridian's coal is relatively uneconomic lignite in the Fort Union region and much of our subbituminous coal compares unfavorably with the highest quality coal elsewhere in the Powder River region. While Meridian holds no federal coal leases and has been tied to this randomly selected reserve base in the checkerboard, other major coal companies, including Meridian's own lessees, have carefully chosen their reserves for production potential and from both private and federal lands throughout the West. When they did turn to the checkerboard to lease Meridian coal, they high-graded our randomly-acquired holdings by agreeing to lease only our most competitive coal, leaving us with mostly economically marginal and uneconomic reserves still within our control.

More significantly, when our unobligated reserves -- the only reserves we can develop in the foreseeable future -- are considered alone, the inability of Meridian to gain economic ascendancy in the western coal business is readily exposed. Presently, some 42 percent of our subbituminous coal reserves and 22 percent of our lignite are leased out under long-term renewable leases to other coal companies. I want to reiterate that these long-term leases do not expire until well past the year 2000. Most have primary and secondary terms of 20 years; some have primary and secondary terms of 30 years; and some even have three terms. Few of these leases have yet reached the end of their primary terms. Given this leasing activity, Meridian's unobligated coal holdings do not now and will not in the foreseeable future approach 15% of the uncommitted reserves in any definable market -- the lowest market share which the Antitrust Division of Justice found in its 1980 report on competition in the coal industry could present a threat to competition.

Even though Meridian does have 4 billion tons of subbituminous coal and 5 billion tons of lignite unobligated and thus capable of development, very little of it could be developed in the near future. The lignite Meridian owns in the Fort Union region is too low in heat value to compete in most markets with the subbituminous or bituminous coal found in all other western federal coal regions. The lignite reserves will be developed only for power generation or synthetic fuel production at the mine site.[1] Suffice it to say we are not being deluged by inquiries from utilities seeking to site new generating facilities or companies wishing to place synthetic fuel plants in the Fort Union region. Certainly, the subbituminous coal in the Powder River region is far more competitive than the lignite in the Fort Union region. But, to Meridian's regret, the subbituminous coal in the Montana portion of the Powder River region where the checkerboard and Meridian's coal are located is not as economical to mine as the coal in the Wyoming portion where Meridian has no ownership position. To compound our problems, most of the subbituminous coal that Meridian has left unleased is either unmineable or uneconomic to mine. It is found in the Custer National Forest which, by statute, cannot be mined, or elsewhere in scattered tracts which have questionable production potential because they are too small, can be developed only by underground mining, are on an Indian reservation, or are in alluvial valley floors where, again, mining is proscribed by statute.

Of these numerous problems associated with our coal holdings, only the problem of scattered, insufficiently-sized tracts would be relieved by a lifting of the section 2(c) leasing ban. As the remaining problems would be unaffected by this legislative relief, the vast preponderance of our reserve base would still be unavailable for production by us. Instead, our hope is that section 2(c) legislation would present us with a few discrete opportunities to compete in the federal coal leasing program -- hardly the dream of a potentially dominant or domineering coal company.

---

[1] Accordingly, concerns expressed about the ability of the Burlington Northern holding company to favor its coal affiliate's coal by having its railroad affiliate discriminate against other companies' coal in freight rates or service is wholly inapplicable to 55% of Meridian's unobligated coal reserves.

We heartily concur with the Interior Department, the Justice Department, the last four Administrations, and the Linowes Commission that section 2(c) should be repealed. We sincerely believe that our opponents' arguments against repeal are unpersuasive and, indeed, may be embarrassing when turned around and applied to our opponents' own legislative agenda. Our opponents suggest that they would be exposed to unfair competition if they were stripped of their section 2(c) protection; they fail to mention that the statutory state and national acreage limitations and the section 15 Department of Justice lease-by-lease anti-trust review are newer, better, and more equitable protections provided by Congress in 1976. To support their effort to preserve section 2(c), our opponents claim the provision is still needed because little has changed in the 65 years since 1920 when it was enacted; then, in virtually the same breath, they support their effort to repeal two lease restrictions -- sections 3 and 7 -- which apply to them by asserting that circumstances have changed dramatically in the brief nine year period since those provisions were enacted. They claim that the lease restrictions of sections 3 and 7 are no longer needed to serve the purpose for which they were written, are redundant to other provisions which properly serve that purpose, are draconian, and are anticompetitive. But they conveniently forget that these very same reasons were given by the Justice Department and the Linowes Commission for the repeal or amendment of section 2(c).

We believe that a comprehensive review of all leasing restrictions -- section 2(c), section 3 and section 7 restrictions -- will show that all need to be modified, if not repealed, and for identical reasons: they unfairly discriminate against certain competitors; they frustrate coal production and competition; they are too punitive; and they are no longer necessary to achieve the public interest. We commend the Committee for its willingness to consider repealing or modifying all three provisions. We urge a complete package of reforms in the law governing federal coal leasing.

Senator Ford. Mr. Wilson, do you care to make a statement?

Mr. Wilson. Yes, I would like to.

STATEMENT OF JAMES C. WILSON, PRESIDENT, ROCKY MOUNTAIN ENERGY

Mr. Wilson. My formal statement is submitted on behalf of the three rail-affiliated coal companies and I'm going to simply focus on that portion of the statement by way of summary here, that outlines our proposal for modification of 2(c).

Senator Ford. That's mighty fine, and your total statement will be included in the record as if given.

Mr. Wilson. Thank you, Mr. Chairman. I want to start out by telling you that for the last 9 months, this group has made a sincere and good faith effort to negotiate 2(c) modification, which in our view reflects the concerns that we've heard expressed by our coal industry brethren to the right end of this table.

Two successive efforts were engaged in; that is, with two different coal industry committee groups. Dialog took place, indeed as Mr. Holsten says. We sense the concerns expressed during that dialog, attempted to respond to those concerns, have never had a response to the concrete proposals that we presented to those two groups, unless and until today's presentation by Mr. Holsten would be perceived or viewed as a response.

In response, as I say, to the embedded concerns held by those who oppose our entry into the Federal Coal Leasing Program, this proposal that we have developed we think responds realistically to their concerns and in fact goes beyond their concerns, goes beyond what would in all reasonable terms be required of us, but our effort and our determination to satisfy those concerns has taken us to that—has made us willing to go to that extreme.

The two dominant areas that we heard from them involved these: First, the assertion that rail-affiliated coal companies enjoy, by virtue of those land grant holdings, an unfair economic advantage in bidding for Federal coal leases within our land grant areas; the second major concern—and you've heard already from it down the table and you'll hear more of it from me and others—the second concern is that the rail-affiliated companies might receive special discriminatory treatment from their affiliated railroads for the transportation of their coal.

Frankly, the three of us here do not believe the expressed concerns about 2(c) repeal have any real merit at all but, nevertheless, have responded to those perceived anxieties, those concerns, and have done so in this way—and let me quickly outline how we have responded.

We have committed to make drilling and other geological data available from our sections, interstitial to the Federal sections, agreed to make those available to other coal companies interested in assessing the value of the adjacent Federal coal at a modest cost and in a fashion quite consistent with the regulations that now permit companies to assess the Federal coal properties. So there is no data restriction here.

We have committed to lease cooperatively when the Secretary of the Interior has determined that it would enhance competition to have cooperative leasing, when terms have been—mutually agreeable terms have been negotiated between the Secretary and one of the participating companies, and would contemplate that our willingness to engage in such cooperative leasing would entitle us to bid in that area.

We have not only accepted the absolute acreage limitations that are incorporated in the law right now and which are themselves reasonably restrictive, but we have agreed to offer to impose even further acreage limitations on ourself to dispel the notion that we hear constantly, that somehow, given modification of 2(c), one or more of the three of us would come to dominate the western coal industry—which has no basis; it is a fantasy.

What we have said in addition to the 100,000-acre limitation that now applies to us all in all States and the 46,080-acre limitation that applies to all of us in any one State, that we would accept a 23,040-acre limitation in the land grant area in all the States; so that we have placed, in effect, a double jeopardy on ourselves, reluctantly, but at the same time we're here to say willingly, in order to get by this notion that we're going to wield some unimaginably powerful club.

It's also been alleged that we're going to have an unfair advantage in bidding on these leases simply because we own the property and have no royalties to pay on the property. We think this, too, is a fantasy. I think any reasonable, astute business executive knows that any owned resource, if it has other applications, the value of those other applications are the costs to it. You wouldn't give away those values.

The Linowes Commission recognized this and dismissed the notion, calling it opportunity cost or referring to it as opportunity cost, dismissed the notion that it gave us any advantage at all. It was fully equivalent in their mind to our having to pay royalties, full rate royalties to a third party.

Now, the second broad area that I mentioned has to do with the potential rail rate discrimination. Basically, the three of us feel that the laws of the land governing anticompetitive behavior apply equally powerfully to us as they apply to the companies down the table and the companies with which they're affiliated and all other industries.

It's against the law to discriminate and behave in an anticompetitive way. We all realize that and we know the significant consequences of departing from that behavior.

Nonetheless, our amendment would require a very specific response to their expressed concern. It would require a rail-affiliated coal company, before it ships coal from any Federal lease it holds in its affiliate's exclusive railroad service area, the railroad and the affiliated company must submit to the Secretary of the Interior the subject coal supply contract, the transportation contract, and any request to bid and responsive bids for the transporting of competing coal to the same purchaser as the rail affiliate's prospective customer. In other words, disclosure is the key to determining whether discrimination is afoot.

Disclosure was a problem expressed to us early in the short-lived dialog with our coal industry friends. We have, in consultation with our railroad affiliates, developed a concept that we could live with, which means we'll put it on the table and if discrimination can be recognized out of this pattern by the Secretary, the very fact that the Secretary would disclose these documents to any complaining competitor would give him the ability to take appropriate action within all of the laws available to any of us to fight discriminatory behavior.

Senator Ford. Mr. Wilson, are you nearing the end?

Mr. Wilson. I am indeed.

Mr. Chairman and members of the committee, we're not proposing repeal of 2(c). We're proposing a serious, severely limiting set of modifications of 2(c). It would allow us to engage directly in this business. It would enhance competition. It would be indeed in the public interest, in our view, and we would hope that these kinds of considerations would be received seriously and weighed heavily by the committee.

Thank you.

[The prepared statement of Mr. Wilson follows:]

STATEMENT OF JAMES C. WILSON, PRESIDENT, ROCKY MOUNTAIN ENERGY

Mr. Chairman and Members of the Subcommittee:

My name is James C. Wilson and I am President of Rocky Mountain Energy (RME), the Denver based mining subsidiary of the Union Pacific Corporation. RME is a diversified mining company and major developer of coal, uranium, and trona (natural soda ash) with additional interests in sand and gravel, grit, and other industrial minerals.

Joining me are R. T. Zitting, President of SF Minerals and G. W. Thompson, President and Chief Executive Officer of Meridian Minerals. We three are appearing together, unified in support of legislative modification of section 2(c) of the 1920 Mineral Lands Leasing Act.

Before moving to our joint statement on section 2(c), Mr. Zitting will briefly share his personal insights and company perspective regarding 2(c). Mr. Thompson will discuss the 2(c) experiences of Meridian Minerals. I will conclude our appearance by presenting a joint statement in behalf of all three companies.

Mr. Zitting . . .

Mr. Thompson. . .

JOINT STATEMENT

I am pleased to join my distinguished coal industry colleagues, and particularly to associate myself with the preceding comments of Mr. Zitting and Mr. Thompson. With the Chairman's concurrence, I would like to add a personal preface to our joint statement.

One problem with keeping an obsolete statute on the books is that it is available for misuse by potential litigants for objectives that have nothing to do with federal coal leasing or with the original purpose of section 2(c).

The railroad coal affiliates have recently been subjected to a spate of expensive law suits based on 2(c). Even though 2(c) has nothing to do with land exchanges, the coal industry associations have invoked 2(c) in law suits attempting to defeat exchanges of federal coal lands with railroad affiliates which the Secretary of the Interior has found to be clearly in the public interest in the exercise of his exchange authority under the Federal Land Policy and Management Act. Similarly, two public utilities have recently tried to use 2(c) as a ground for voiding coal contracts with Rocky Mountain Energy joint ventures, even though the utilities have not even claimed to have been harmed in any way by what they characterize as a violation of 2(c).

The courts have so far decisively rejected both these kinds of attempts to use 2(c) for ulterior purposes. But until 2(c) is changed to eliminate the ban on leasing to railroads and railroad affiliates, it will continue to be a source of mischief and down-right harassment of railroad coal affiliates by litigation-minded adversaries.

Before moving to our detailed testimony, I would note RME's concurrence with others in the coal industry as well as with the Interior Department and the Linowes Commission that modification of section 3 of the Federal Coal Leasing Amendments Act is appropriate and necessary. I would urge this Subcommittee to carefully consider the recommendations for modification of section 3 proposed by the Linowes Commission.

The last time we discussed 2(c) with you was during a similar hearing before the Energy and Mineral Resources Subcommittee in September, 1981. As you are aware, our three companies share an unusual and often compelling distinction in the coal industry -- we are known as the rail-affiliated coal companies. We especially appreciate your invitation to again collectively address issues which affect our part of the coal industry.

We commend Chairman McClure for his continued sensitivity and effort to improve the Federal coal leasing program. Our proposal to modify section 2(c) of the 1920 Mineral Lands Leasing Act is consistent with the McClure Amendment 802 (to S.570) introduced October 17, 1985.

An administrative re-interpretation of the 1920 Mineral Lands Leasing Act by the Department of Interior gives us a special but undeserved status of being locked out of the Federal coal leasing program. Section 2(c) of that Act prohibits railroads from acquiring federal coal leases. Specifically section 2(c) states that:

> No company or corporation operating a common carrier railroad shall be given or hold a permit or lease under the provisions [of the Mineral Lands Leasing Act]. . . for any coal deposits except for its own use for. . . railroad purposes.

The Department of Justice has taken the position that section 2(c) also applies to independent coal companies affiliated with a common carrier railroad, as distinguished from the railroad itself. The Department of the Interior had held a long standing position to the contrary, based on a series of Solicitors' opinions issued during the 1970's. In 1982 the Solicitor revisited the two departments' positions and determined that reliance on either one was likely to lead to litigation. To minimize that likelihood, the Interior Department chose to suspend any further leasing to railroad coal affiliates. We disagree with this re-interpretation and decision. It is important to note that both departments continue to advocate repeal of section 2(c), despite this re-interpretation.

Today the railroad-affiliated coal companies, Meridian Minerals, SF Minerals, and Rocky Mountain Energy, are submitting a unified statement which places before Congress a possible solution to the 2(c) issue. We do so by re-emphasizing our view that 2(c) is only one of two statutory restrictions that reduce the competition for federal coal. The other restriction is, of course, section 3 of the Federal Coal Leasing Amendments Act of 1976.

We support legislation dealing with the full scope of the coal leasing recommendations of the Linowes Commission, including its conclusions that modification of sections 2(c) and 3 is appropriate. Both prohibit companies from acquiring leases for reasons that are unfair and grant competitive advantage to others, and therefore both should be modified. We do not believe that one can fairly be addressed in isolation from the other.

Several Congresses have considered 2(c) and have heard strong arguments in favor of repeal. A major reason why repealing 2(c) has nonetheless been so difficult can be found in the size of its constituency. The three companies before you are viewed as the only constituency which would directly benefit from modification of 2(c). This is not true, in fact, since consumers and federal tax payers would benefit from increased competition, but it is still widely perceived as true.

We believe that the constituency with a strong interest in opposing repeal is also small. There are companies, however, which agree that the prohibitive nature of 2(c) is unfair, but nevertheless continue to oppose its repeal or modification because they are advantaged by its existence. In seeking support for this issue, we are continually asked, "What's in it for my company if we support repeal?" As long as opponents continue to wear blinders, there is no answer to that question which is consistent with their vested financial interest.

The issue for Congress to consider, however, is really the integrity of the Federal coal leasing program and the competitive health of the entire coal industry.

We have chosen to focus our testimony today on the 2(c) issue because we believe the time has come to remove this persistent impediment to the development of important federal resources. We view 2(c) as anachronistic, redundant, and anti-competitive. Section 2(c) is anachronistic because during the sixty-five intervening years since passage, it has outlived whatever purpose it may have served. Fear that western railroads would dominate coal production if they had access to federal coal leases is no longer plausible -- if it ever was. If the railroads ever had a dominant position, it has long since disappeared with the entry of electric utilities, major oil companies and large nationally based coal companies into western coal development.

As early as 1970, the Public Land Law Review Commission in its report to Congress stated that the fears of monopolistic control which led to the enactment of the existing restrictions of section 2(c) were no longer appropriate and recommended repeal of 2(c). The Justice Department's Antitrust Division concluded in its 1980 report entitled "Competition in the Coal Industry" that section 2(c) was no longer necessary. That conclusion is particularly significant because the Justice Department began its study with the assumption that section 2(c) was still needed to protect competition, but was persuaded by its in-depth review of the coal industry and Western railroads that there was no basis for the concern.

Section 2(c) is also redundant. The Federal Coal Leasing Amendments Act of 1976 already provides a carefully constructed provision designed to enhance competition. Section 15 of the 1976 act requires the Attorney General to review every lease on a case-by-case basis to determine if it would create or maintain a situation inconsistent with the antitrust laws. With the Section 15 Justice review in place and working, the blanket restriction of 2(c) is not necessary.

As the Antitrust Division has emphasized, section 2(c) is also anti-competitive. Competition for Federal coal leases is now considered as the best means of avoiding market dominance by large coal producers in the West. Section 2(c), by restricting our participation in bidding for federal coal leases, detracts from rather than protects competition. An artificial barrier exists against bidding for Federal coal leases for an entire class of potential competitors as long as section 2(c) resides in the statute books. The Justice Department reached the same conclusion in its 1980 report:

> Leasing to railroads can also be competitively beneficial by allowing additional competitors to enter the market....Plainly, whatever the merits of a general prohibition to leasing to the railroads in 1920, the broad sweep of section 2(c) is now an impediment to rather than a bulkwark [sic] of competition. [Competition in the Coal Industry, 88-89, 1980]

For similar reasons, the Linowes Commission also concluded in its 1984 report to Congress and the Department of the Interior that section 2(c) impedes the development of federal coal and its leasing ban should be removed. We are here today to present our proposal to improve the Federal coal leasing program by modifying section 2(c) of the Mineral Leasing Act. We ask for no different treatment than asked for by oil, gas and other coal companies seeking relief from another Mineral Leasing Act prohibition on lease issuance which is applicable to them....a prohibition contained in section 3.

Within the context that 2(c) and section 3 are impediments to the development of federal coal, we will present a legislative amendment which:

a) modifies the exclusionary aspects of section 2(c) to allow railroads and their affiliates to lease or hold federal coal leases under certain circumstances, and which

b) sets forth sufficient safeguards to meet any colorable objections to modification asserted by other interest groups and coal companies already involved in the Federal coal leasing program.

Before sharing our proposed amendment to modify section 2(c), I would like to describe the activities of the coal industry over the last nine months regarding section 2(c). We entered into a negotiation process with the coal industry on the basis that it provided a mechanism, heretofore absent, to openly air the industry's concerns about perceived unfair economic advantages and the potential for discrimination, and to craft a compromise with which both sides could live.

In all candor, Mr. Chairman, while we believe outright repeal is appropriate, we have nonetheless stepped back from that position in a sincere effort to accommodate the stated concerns of the coal industry. As my testimony will show, the rail-affiliated coal companies have clearly moved far beyond the position of outright repeal of 2(c).

RECENT 2(c) CHRONOLOGY

In February, in response to remarks by this Committee's Chief Counsel to the Coal Leasing Committee of the American Mining Congress (AMC), an Ad Hoc Committee was established to review and make recommendations on 2(c) repeal. Meetings were held between rail-affiliated coal companies and members of the coal industry concerned about changes in section 2(c). At a mid-March meeting of the AMC Ad Hoc Committee, our three rail-affiliated coal companies presented a conceptual proposal to the coal industry to modify section 2(c). Let me emphasize modify rather than repeal. The proposal not only incorporated the 2(c) recommendations of the Linowes Commission and included a provision to protect against any potential for rail rate discrimination, but also responded to each and every concern aired by the industry in the earlier meetings.

The Ad Hoc AMC Committee did not respond to our conceptual proposal.

In the meantime, the National Coal Association (NCA) Board voted again to oppose any 2(c) amendments. This vote came before any response to our proposal had been rendered by industry members of the Ad Hoc Committee. Industry leaders also met with Congressional Committee chairmen and section 3 legislative sponsors and expressed opposition to any section 2(c) amendments.

In early June, the House Subcommittee on Mining and Natural Resources held legislative hearings on proposed coal leasing. The conceptual proposal previously submitted to the Ad Hoc AMC Committee was outlined by the rail-affiliated coal companies to the Mining and Natural Resources Subcommittee.

Believing that the AMC process had gone dormant because no response had been made to our conceptual proposal, the rail-affiliated coal companies proceeded to develop legislative language. The legislative amendment essentially reflects the conceptual proposal in all respects except that the section dealing with potential rail discrimination was revised in a manner that we believed was responsive to the coal industry and which improved our proposal to modify 2(c).

In mid-July, the NCA Chairman requested a meeting with me during which new negotiations on 2(c) with an ad hoc industry were proposed. In late July, the House Subcommittee reported section 3 legislation. Shortly thereafter, the new negotiation group held two productive meetings which led us to believe progress toward compromise was being made.

Nonetheless, in mid-September I received a letter from the NCA chairman which dismissed the coal affiliates' legislative proposal as insufficient, suggested that changes in acts other than the 1920 Mineral Lands Leasing Act were necessary, and stated that with respect to transportation contracts "...a genuine resolution of this issue can only be achieved through revisions of the Staggers Rail Act of 1980...."

In essence, their response suggested that the stakes were not high enough and that the discussion must now be broadened to include Staggers. Such tactics offend my sense of good faith negotiation; Staggers is an issue totally unrelated to federal coal leasing. We have expressed disappointment at the lack of industry understanding of our proposal and its failure to provide any alternatives. We have suggested that an agenda or proposal be supplied by the industry prior to further meetings.

Mr. Chairman, for the last nine months we have made a good faith effort to negotiate a 2(c) modification which reflects coal industry concerns and is modeled after the recommendations of the Linowes Commission. Two successive efforts have failed to produce a compromise or substantive alternatives for a 2(c) modification which could be presented in tandem with section 3 modifications by a united industry.

Our goal, as we believe yours to be, is to improve the Federal coal leasing program by removing impediments to the development of federal coal resources. Section 2(c) is bad public policy just as section 3 as currently written is bad public policy, and should be modified.

In response to the embedded concerns and perceived difficulties held by those who oppose our entry into the federal coal leasing arena, we have developed a proposal which stops well short of repeal, but allows us to lease federal coal within certain conditions and constraints.

LEGISLATIVE AMENDMENT

Two dominant areas of concern have been expressed by those opposing repeal of section 2(c). The first is the assertion that the railroad affiliated coal companies enjoy, by virtue of their land grant holdings, an unfair economic advantage in bidding for federal coal leases within their respective land grant areas. The second concern is that rail-affiliated companies might receive special discriminatory treatment from their affiliated railroads for the transportation of their coal, particularly in cases where competing coal companies have no rail transportation alternatives for their resource.

We do not believe the expressed concerns about 2(c) repeal have merit, but nevertheless have responded to those concerns.

The foundation of our proposal which responds to these concerns can be found in the 2(c) related conclusions of the Linowes Commission report entitled "Fair Market Value Policy For Federal Coal Leasing." We note that some of our coal competitors who are making an effort to fashion a compromise on section 3 have also substantially relied on the same Linowes Commission report.

UNFAIR ECONOMIC ADVANTAGE

Some coal companies believe that the railroad land grant holdings afford rail-affiliated coal companies with unfair economic advantages in bidding on federal coal leases for three different reasons. These concerns can be summarized as follows:

1. That rail-affiliated coal companies possess data on their own resource which gives them an advantage over other prospective bidders in determining the potential of the interspersed federal lands of their land grant areas.
2. That were the rail-affiliated company to be the losing bidder on a federal lease, it could possibly refrain from leasing its resource to the successful bidder, thereby frustrating development of the interspersed federal land, and that as a result, prospective bidders might be deterred from competing for the lease or at least lowering their view of the fair market value of the federal lease.*

---

*This possibility already exists, of course, in other areas of mixed ownership and in areas of rail-affiliated coal already leased.

3. That the rail-affiliated coal company does not have to pay a royalty on its own coal, and therefore has more money available to bid against other competitors for federal leases.

The Linowes Commission's conclusions as to 2(c) are straightforward and respond directly to the concerns regarding the advantages which a railroad affiliated coal company is alleged to have. In order to develop federal coal in the railroad land grant areas, the Commission report stated that "Congress should repeal section 2(c) of the Mineral Lands Leasing Act, but a railroad or its affiliate should be allowed to bid for Federal coal leases within its land grant area only if":

1) it releases exploration data on its own coal holdings within the land grant which are interspersed with the Federal tracts to be leased, and
2) the affiliate or railroad agrees to participate in cooperative leasing of Federal and railroad coal.

Our proposal satisfies these conditions.

So as to avoid any disadvantage to other bidders concerning the extent and location of the coal resource, our proposal would require us to make our coal resource data available to other prospective bidders upon payment of a reasonable portion of the cost of developing that data whenever federal and railroad coal is to be leased cooperatively. This is similar in concept to the way costs are currently shared under federal coal exploration licenses.

With respect to the second condition to repeal of 2(c) suggested by the Linowes Commission, we are prepared to accept the concept of cooperative leasing. It would take place in situations where a railroad or affiliate desires to bid on a lease for federal coal in a potential mining unit which includes its own land grant coal and the Secretary of the Interior determines that cooperative leasing would substantially enhance competition.

Under cooperative leasing, the affiliated coal company would notify the Secretary of its desire to bid on a federal lease tract of a mining unit which also contains land grant coal. This notice would trigger negotiations between the Secretary and the affiliate to determine mutually agreeable terms for leasing its coal within the potential mining unit. The Secretary must bar the affiliate from bidding on the tract if the negotiations on terms fail to reach agreement.

Cooperative leasing, however, should not be required if the Secretary of Interior does not find that cooperative leasing would significantly enhance competition or where the railroad or affiliated company has a less than 30 percent interest in a joint venture which would own or control the federal lease. Cooperative leasing would also be subject to exceptions where the coal deposits to be included in the federal lease ___

(i) amount to less than 35 percent of the estimated recoverable reserves in the potential mining unit; or

(ii) would be bypassed if not leased to the rail-affiliated coal company, or are required to maintain on ongoing mining operation of the railroad or the affiliated coal company in the potential mining unit; or

(iii) are within or adjacent to the permit area of a mining operation owned by an affiliated coal company (in existence and operating at time of passage of this legislation) that has coal already committed to a purchaser prior to the date of enactment.

The reason for the first of these exceptions to cooperative leasing is that it would not be equitable for a minority owner of less than some reasonable percentage -- we propose 35 percent (of the coal which could be mined in conjunction with the lease) to dictate the nature, timing, and scope of development to the majority interests.

The reason for the second set of exceptions is that the special maintenance and bypass considerations found in present day federal leasing policy should be equally available to railroads or their affiliates as they are currently to other federal lessees. These considerations allow the Secretary to make small parcels of coal available to large on-going mining operations in order to avoid loss of the reserves to meet short-term needs.

We are not talking here about a left-handed maneuver to avoid cooperative leasing or circumvent existing policy. We want it clearly understood that these exception provisions do not sanction one-section mines, or the securing of contracts for more coal than is available in that section, and then plead maintenance or bypass to acquire the contiguous federal coal. There is no intention to place the Secretary in a position to grant four sections of federal coal around a one section mine. This far exceeds the spirit and purpose of the by-pass and maintenance authority.

Finally, with respect to the third exception, a company which has already opened a mine on its coal holdings and obtained a contract committing its coal to a purchaser should not be subjected to the risk of divesting itself of that investment as a condition to bidding on federal coal which is within or adjacent to its permit area. This provision is quite limited since it applies to only existing mines which, I believe total two in number, SF Minerals' Lee Ranch and RME's Leucite Hills.

Our proposal also includes an absolute limit on the amount of federal coal within its land grant which a railroad or its affiliate can lease. To prevent any one coal company from dominating the Federal coal leasing program, the Federal Coal Leasing Amendments Act of 1976 provides a state and national limitation of 46,080 and 100,000 acres, respectively, on the holding of federal coal leases by any company.

We are prepared to go one step further: in addition to the current limitations, we would accept a more rigid multi-state acreage limit on federal coal leases held by railroads or their affiliates within their respective land grant area, whether acquired directly from the Secretary or otherwise under the 1920 Mineral Leasing Act. This special limitation of 23,040 acres would apply to railroad coal throughout its specific land grant area and would not replace or modify, but be in addition to the current limitations. We would then be subject to three limits rather than two. Let me give you an example.

Rocky Mountain Energy is charged with approximately 14,000 acres through existing joint ventures, all of which are within the Union Pacific land grant and are in Wyoming. If we were to then lease 9,000 federal acres in the Utah portion of the land grant (or the Wyoming portion), we would not be able to lease additional acreage in any state within the land grant. We could lease the remaining balance of the 46,080-acre state limitations in Wyoming and in Utah, or in any other state but only outside the land grant area. Total acreage, of course, would be limited to 100,000 acres nationally.

With respect to the allegation that rail-affiliated coal companies have an unfair economic advantage because we pay no royalty on our own coal, we concur with the Linowes conclusion which dismisses the allegation as unfounded. The Commission succinctly noted that:

> this concern ignores the fact that the railroad thereby foregoes the opportunity to receive royalties from another company. This opportunity cost would be just as great if the railroad were required to pay the royalty to another party. As a result, no special bidding advantage would accrue to the railroad for cooperative leases. (Emphasis added)

In short, the allegation ignores opportunity costs. If I went to the Union Pacific Corporation Board of Directors to ask them to authorize capital expenditures of $75 million to earn a return on investment of 15 percent and said, "By the way, I may decide to bid away the prospective royalty value on that coal," their response would be quick; "Jim, why don't you let someone else put up the $75 million, and we'll just take the royalty." No company, whether affiliated with a railroad or not, would put capital at risk to lease and develop federal coal if it can receive a comparable return through leasing its own coal without any risk whatsoever.

We are no different than any other owner of coal adjacent to federal coal. Our land holdings are assets which our predecessors earned and which were subsequently bought and paid for by the present Union Pacific. For the record, we are submitting a document entitled: "Railroad Land Grants: Paid for in Full." It traces public policy which encouraged railroad construction based on land grants and identifies the debt repayment. Suffice it to say that suggestions or statements that our land and mineral resources were given to us and acquired at no cost are without basis. Both Congress and the Supreme Court have determined that the books are closed on the matter of the adequacy of railroad payments for their land grants.

POTENTIAL DISCRIMINATION

The second major concern expressed by those opposing repeal of section 2(c) is the potential for rail rate discrimination by affiliated railroads favoring an affiliate's coal over a competitor's coal. We continue to share the views of the Justice Department, the Interstate Commerce Commission, and the Congressional Research Service that the Interstate Commerce Act, the Sherman Antitrust Act, and other existing acts and mechanisms are adequate to deter and remedy any discrimination. Yet, the non-railroad affiliated coal companies continue to assert they do not have sufficient and timely access to coal supply and rail rate contract information to determine if legal action is necessary.

Many of those coal companies opposed to repeal or modification of section 2(c) are affiliates just as we are affiliates. But instead of being affiliated with railroads they are affiliated with major oil companies and diverse energy conglomerates. These parents or affiliates explore, develop, process or refine, market and transport their resources in classic, vertically integrated operations. To allege potential for discrimination by railroads and affiliated coal companies, while at the same time overlooking the comparable association within their own corporate structures undermines this complaint. The same antitrust safeguards which apply to these corporations also apply to the Union Pacific, Burlington Northern, and Santa Fe Southern Pacific.

In an effort to avoid any possible concern, we propose as a major element of our 2(c) amendment to the Mineral Leasing Act a special provision which requires the disclosure of coal supply and transportation contracts under certain conditions. At the risk of being repetitive, let me again emphasize that this antitrust safeguard is in addition to those under which all other corporations in the country must exist. In retrospect, it's rather ironic that we are suggesting a safeguard against potential discrimination, which on its own merits discriminates by prescribing a different, more stringent set of rules for affiliated coal companies than required for the rest of industry.

Nonetheless, our amendment would require that before a rail-affiliated coal company ships coal from any federal lease it holds in its affiliate's exclusive railroad service area, the railroad and rail-affiliated company must submit to the Secretary of Interior the subject coal supply contract, the transportation contract and any requests to bid and responsive bids for the transportation of competing coal to the same purchaser. The Secretary must disclose these documents to a complaining coal competitor who made a competitive supply bid to the purchaser and who had no reasonable transportation alternative to the railroad if the railroad did not respond to a request to bid on transporting the complainant's coal with a bid identical in all material respects to the terms agreed to in its transportation contract with the purchaser. The transportation contract cannot become effective until 35 days after its submission to the Secretary. Further, the complaining competitor can use the disclosed contracts and bids in litigation it wishes to bring regarding the subject contract.

In summary, Mr. Chairman and Members of the Subcommittee, we have discussed this legislative amendment with our respective railroad affiliates, and they join us in advancing it as a workable and more than fair modification of section 2(c). It does not repeal section 2(c), would not eliminate section 2(c), and would not allow rail-affiliated coal companies to lease federal coal without restrictions. It is a tough provision, more restrictive than any other proposal to modify or repeal 2(c), including the Linowes Commission recommendation.

We believe this proposal to modify section 2(c) should be enacted into law for the following reasons:

1. Modification of 2(c) will improve planning and management of Federal tracts within the land grant areas as well as associated state and fee tracts.
2. Increased competition, due to the addition of railroads or their affiliates as potential bidders, will improve the potential for additional revenues to the Federal Government and will add potential sources of coal supply.
3. Cooperative leasing as a condition to modification of 2(c) will enhance competition and will ensure equal access by all companies to federal coal in land grant areas.
4. The concerns and fears consistently raised by those who oppose our entry and participation in the Federal coal leasing program have already been addressed in existing law. Statutes on the books adequately safeguard against alleged unfair economic advantage and the potential for anti-competitive, discriminatory activities.
5. The additional conditions imposed upon railroad coal leasing under our amendment are not required of any other party wanting to bid for and hold

federal coal leases, and therefore provides extraordinary additional assurances that railroad coal affiliates will not enjoy unfair economic advantages in bidding for and marketing federal coal.

Mr. Chairman and Members of the Subcommittee, we are not the only proponents of 2(c) modification. Several western coal state governors have submitted statements for this and previous records in support of 2(c) modification. The Justice Department, the Interior Department, the Linowes Commission, the Public Land Law Review Commission, and others agree that section 2(c) is anachronistic, restricts competition, and inhibits the sound management of interspersed federal, state and private lands in the land grant areas. Section 2(c) also lowers the potential for receiving fair market value and reduces the potential for mineral leasing income to the Treasury.

According to the Department of Justice:

> Any competitive problems arising from leasing to railroads can be dealt with on a case-by-case basis by the Department's review of leases to determine whether they would create or maintain a situation inconsistent with the antitrust laws. The review under section 15 of the FCLAA is better adopted to the nature of the problem than the outright prohibition on leasing to railroads

> of section 2(c). It will free the railroads to enter the coal industry as vigorous competitors, but will prevent them from receiving federal leases when the result might be anti-competitive.

Why is the resistance and opposition to modification of 2(c) so strong? The answer is competition, plain and simple. It is raised by those who would deny our role in a truly competitive situation.

We seek only the right to compete on equal terms with other coal companies, oil and gas companies, multi-resource corporations, and other individuals or groups, in bidding for federal coal leases. Section 2(c) no longer serves its original purpose. Its modification would promote competition.

In closing, we appear together in lockstep support of our amendment and Amendments 801 and 802 proposed by Senator McClure. We appreciate the opportunity to present our joint statement. At the appropriate time, we would each be pleased to respond to your general questions regarding our proposal or other questions more specific to our individual companies. Thank you.

AMENDMENT

Insert a new section ______, as follows:

SEC. _____. Section 2(c) of the Mineral Lands Leasing Act (30 U.S.C. 202) is amended to read as follows:

"(c)(1) A common carrier railroad company or any company that controls, is controlled by, or is under common control with such company (hereinafter in this subsection referred to as a "railroad or affiliated company") may hold leases of coal deposits pursuant to this Act subject to the special conditions on (i) lease bidding in paragraph (2); (ii) lease holdings in paragraph (3); and (iii) transportation of leased coal in paragraph (4).

"(2)(A) No railroad or affiliated company shall be eligible to bid for a lease under this Act of coal deposits that are adjacent to coal deposits which (i) are in lands granted by the United States to such railroad or affiliated company or to a corporate predecessor thereof and (ii) are owned by such company (hereinafter in this paragraph referred to as "the federal lease") unless such company notifies the Secretary of its intention to bid by a date, established by regulation, prior to the sale of the federal lease. Whenever such a notification has been received and a tract for the federal lease has been delineated, the Secretary shall identify a potential mining unit containing the federal lease (hereinafter in this paragraph referred to as "the potential mining unit") and, if he finds that competition for the federal lease would be substantially enhanced thereby, shall require as conditions to the right of the railroad or affiliated company to bid when and if the federal lease is offered for sale, that, prior to the sale, the railroad or affiliated company shall -

"(i) upon request, make available at reasonable cost to any potential bidder for the federal lease any and all exploration data in the possession of the company concerning the extent and nature of the land-grant coal deposits within the potential mining unit; and

"(ii) agree that, if not the successful bidder for the federal lease, it will offer for lease the land-grant coal deposits owned by the company in the potential mining unit on reasonable terms which are mutually agreed to by the Secretary and the company: Provided, That, whenever the Secretary makes a finding of significant competition enhancement pursuant to this subparagraph (A), he shall promptly enter into good faith negotiations with the railroad or affiliated company to establish such terms and shall not offer the federal lease until such terms are established or he and the company mutually agree in writing that the negotiations have concluded and no agreement on terms can be reached; in which latter event, the railroad or affiliated company shall not be eligible to bid on the federal lease: Provided further, That the Secretary may determine without company concurrence that no agreement on terms can be reached if, after publishing a complete statement of his final offer to the company in the Federal Register and allowing 30 days for a response, the company has failed to agree to such terms.

"(B) After notification to the Secretary pursuant to subparagraph (A), a railroad or affiliated company may bid upon the federal lease without the conditions specified in said subparagraph whenever the Secretary does not make a finding of significant competition enhancement as provided in subparagraph (A), or when the railroad or affiliated company has a less than thirty percent interest in a joint venture which would own or control the federal lease, or where the coal deposits to be included in the federal lease -

"(i) constitute less than thirty-five percent of the recoverable reserves in the potential mining unit; or

"(ii) would be bypassed by or are required to maintain ongoing mining operations owned in whole or in part by the railroad or affiliated company and located in the potential mining unit; or

"(iii) are within or adjacent to the permit area of a mining operation that is owned in whole or in part by the railroad or affiliated company and that is operating, and has coal committed to a purchase, prior to the date of enactment of this subsection.

"(3) Any railroad or affiliated company shall be subject to the acreage restrictions of section 27(a)(1) of this Act and, within these limitations, shall not take, hold, or control at one time, whether acquired directly from the Secretary or otherwise under this Act, leases of coal deposits adjacent to land-grant coal deposits which were granted by the United States to such railroad or affiliated company or to a corporate predecessor thereof and are owned by such company in an aggregate of more than twenty-three thousand and forty acres.

"(4)(A) Whenever a railroad or affiliated company obtains a lease under this Act of coal deposits situated within the exclusive service area of such railroad company, the railroad company may not thereafter enter into a contract to transport coal produced from said lease or from a mining unit that includes said lease (hereinafter in this paragraph referred to as "the Contract") except as provided in this paragraph.

"(B) In addition to any filing which may be required by any other provision of law, the railroad company shall submit the Contract to the Secretary, together with copies of any formal transportation bid notice or request from the purchaser of the coal to be transported pursuant to the Contract (hereinafter in this paragraph referred to as "the purchaser") to which the railroad company responded and all formal transportation bids submitted by the railroad company in response to such notice or request. The railroad or affiliated company shall also submit to the Secretary its supply contract with the purchaser. Within five days of submission of the Contract, the Secretary shall publish in the Federal Register notice of such submission, including identification of the contracting parties, the affected lease, and the lessee. The Contract shall not become effective until thirty days after the date of such publication.

"(C) Within that same thirty-day period, any coal producer (hereinafter in this paragraph referred to as "the complainant") may file a complaint with the Secretary alleging that the Contract is in violation of law and that it prevented complainant from selling its coal to the purchaser in lieu of the coal to be transported pursuant to the Contract. The complainant shall submit with its complaint a copy of its coal supply bid to the purchaser and any other information necessary for the Secretary to make the disclosure determination provided for in this subparagraph. If the Secretary determines that (i) the purchaser requested and received a timely and responsive supply bid from the complainant, the terms of which were substantially similar to those of the supply contract, (ii) the complainant had no reasonable alternative transportation available for its coal except that supplied in whole or in part by the railroad company, (iii) the purchaser requested a bid from the railroad company to transport in whole or in part the complainant's coal, and (iv) the Contract and the bids, if any, submitted by the railroad company to transport the complainant's coal are not identical in all material respects, the Secretary shall disclose the submissions of the railroad or affiliated company to the complainant and the submissions of the complainant to the railroad company (and to its affiliated company, if the latter holds the lease to the coal to be transported pursuant to the Contract).

"(D) The submissions to the Secretary pursuant to this paragraph shall be disclosed by him only pursuant to subparagraph (C) and, except as provided in subparagraph (E), shall otherwise remain proprietary and not be released to any other person or entity, any other provision of law notwithstanding.

"(E) The complainant may make use of the submissions of the railroad or affiliated company solely for the purpose of determining whether a cause of action may exist against the railroad or affiliated company and disclose such submissions solely for the purpose of prosecuting such cause of action. The railroad or affiliated company may make use of and disclose the submissions of the complainant solely for the purpose of defending such cause of action. No other disclosure or use may be made of such submissions."

Senator **Ford**. Let's stay on 2(c) just a little bit, and then we can get into the other parts of your testimony. Senator Johnston's here now. He has the gavel, but I'm going to exercise the prerogative I had before Senator Johnston got here.

Mr. Wilson, let me ask you, you or your representatives were a party in meetings that took place this summer with the coal industry; is that correct?

Mr. **Wilson**. Yes.

Senator **Ford**. Am I also correct that you chaired the railroad group and, as chairman of that group and as a participating company, you were involved in drafting the amendment which Senator McClure has introduced?

Mr. **Wilson**. Senator Ford, it was really a cooperative effort. No one of us chaired it. We worked together. Our staffs worked diligently on it. The three of us here participated in reviewing the elements included in it.

Senator **Ford**. So you had a group without a chairman?

Mr. **Wilson**. We did.

Senator **Ford**. Maybe we ought to try that. [Laughter.]

Mr. **Wilson**. We're enormously pleased that an elephant was not the result.

Senator **Ford**. Well, I could give you something else, but I don't think I should.

Let me quote, if I might, from that amendment, Mr. Wilson. And the quote is: "A common carrier railroad or any company that controls, is controlled by, or is under common control, may hold leases of coal deposits pursuant to this Act, subject to the special conditions on"—that's under (iii) Transportation of Leased Coal in paragraph (4).

Now, we heard earlier from a representative of the coal industry, who indicated they tried on more than one occasion to meet with representatives of the railroad to discuss their transportation concerns as they relate to 2(c).

Can you explain to me why these meetings haven't occurred, or have they been held?

Mr. **Wilson**. I can't explain it fully. Mr. Holsten expressed what he presented to you, a concern that the transportation element of 2(c) was not the whole range of concerns that his associates had about our entry into the coal business.

The whole package of Staggers implications and the whole process of reviewing Staggers were of equal importance and simultaneous importance to him, and I said that's the equivalent of changing the subject on us.

He asked for an audience with the chairman of our holding company and I told him that the chairman of our holding company delegates to me, as the president of the coal company and to John Kennifick, who's chairman of our rail system, responsibility for handling policy positions of this sort. He had no objection to meeting Mr. Holsten. He said if he comes to me and asks me to discuss Staggers as a tradeoff item against 2(c), say, I will simply suggest that he talk to Kennifick in the context of the widespread activities and deliberations that are going on now about Staggers. It is a factor unrelated—an issue unrelated in our opinion—it was in his opinion—to 2(c), although 2(c) has a transportation dimension to it.

We thought that we had addressed in a realistic way the transportation dimension of 2(c) and left it at that.

Senator FORD. So you're saying that the railroad parents were not willing to come to the table on anything other than 2(c). Is that correct, Mr. Wilson?

Mr. WILSON. The railroad could easily have been contacted to discuss Staggers. That kind of discussion, as I understand it, and it's not part of my responsibility, that kind of discussion is going on throughout industry and on the Hill here and so on. It was simply an expression; you talk Staggers to the right people, you talk 2(c) to the right people. That's the way our corporation is organized. We handle 2(c) because it is a coal leasing policy matter.

Senator FORD. Well, apparently the two interrelate, and if you're just unwilling to bring the groups together to talk about the full relationship of the coal leasing and transportation, et cetera, it appears to me that you're isolating each of the problems and trying to talk about those directly. There's no way to get the group down to the table to talk about a comprehensive program.

They're related under this amendment that we have before us now, aren't they?

Mr. WILSON. I don't see how, sir.

Senator FORD. You don't see how?

Mr. WILSON. No.

Senator FORD. Well, transportation contracts are tied into this amendment, so I don't see how you can say they're not included.

Mr. Zitting, you're wanting to get in——

Mr. ZITTING. Yes. Let me speak from the Santa Fe point of view. I don't believe there's been any request of our railroad company or our parent company to discuss transportation issues in connection with this. The transportation provision that was put in the proposed compromise agreement was put in at the insistence and request of the nonrailroad affiliated companies who claim that they had a shortcoming in not being able to get access from the transportation companies of the type of transportation agreements that were being made in connection with coal movements of our coal.

And so that provision is a provision that provides them a way to see those agreements and see if they feel they have a cause for action under the existing laws against anticompetitive behavior. And that's all there is to it.

We've argued with them, and I personally have felt there was really not even the need for that much in this, that they were adequately protected by the laws as they existed, but that we coal companies are certainly not in a position to discuss Staggers or what else these people might want to talk to the railroad about.

Senator FORD. Aren't common carriers specifically exempted under the Federal Trade Commission Act?

Mr. ZITTING. Some of our lawyers are sitting behind us. I guess one of them might respond to that question.

Senator FORD. Well, let me give you what I know, and I'm not a lawyer. That makes it somewhat troublesome, I guess. In testimony before the Linowes Commission, Ronald Young, Director of the Bureau of Accounts of ICC stated—and I quote: "Except in the case of agricultural commodities or challenges by courts, the Commission may not disapprove a contract because a rate unreasonably discriminates against some other shipper. Therefore, it is possible that a rail carrier could negotiate a contract rate with its mining subsidiary which was significantly lower than the rates charged to other coal shippers."

Now, that's what the Director, Bureau of Accounts, ICC said.

I ask you what relief or protection does this amendment provide for the independent coal shipper?

Mr. **Zitting**. Well, there's a large body of antitrust law that has been built up which I believe precludes anticompetitive behavior discrimination by the railroad against any shipper. And I guess I don't believe that that's—there are probably no two freight agreements that are the same anywhere in the coal industry. I believe a railroad negotiates each freight agreement individually, and if any shipper feels that he's been discriminated against, he certainly has the protection of the law.

Senator **Ford**. Well, it's very little law, but the common carrier railroads are specifically exempt under the Federal Trade Commission Act which "prohibits unfair methods of competition."

So they're specifically——

Mr. **Zitting**. Well, I guess they're exempt from the provisions of that act, but they're not exempt from anticompetitive behavior problems.

Mr. **Wilson**. Senator Ford?

Senator **Ford**. You're not exempt from antitrust, that's right. But you're exempt from other things.

Mr. Wilson?

Mr. **Wilson**. I was simply going to observe that the three of us are really not cognizant, because of our own professional orientation and our business assignments, with ICC regulations. We would be pleased to respond, however, in this area or obtain assistance in responding in writing to questions about how ICC regulations may relate to our effort to provide a mechanism for disclosure.

Senator **Ford**. Well, Mr. Holsten, let's get down to you and give you a chance and your people on your side then, and I guess maybe I'd better quit and let my colleague proceed. But, Mr. Holsten, you're familiar with the amendments which Senator McClure has introduced as it relates to section 2(c). Let me hear from you and from any of your colleagues about the provision of those amendments that are acceptable and the provisions which are not acceptable, and basically why.

Senator **Domenici**. Would the Senator yield for a moment, please?

Senator **Ford**. Sure.

Senator **Domenici**. Let me see if I understood Mr. Wilson, Mr. Zitting, and Mr. Thompson. As I understand it, one of the concerns—I mean clearly the fact that you're exempt from the Federal Trade Commission, we don't have to spend a lot of time. You are exempt from that particular entity in terms of discrimination, but nobody is suggesting that you're exempt from the discrimination laws of the land. That's one entity that handles it.

The antidiscrimination laws, many of them, are not within the Federal Trade Commission, but are enforced elsewhere in the courts of the land. As I understood it, one of your proposals addressed the issue that mining companies and coal companies might not know what the contract between you and your railroad was, and didn't you say that as part of your suggested compromise, that those would be filed with the Secretary and be made available from the standpoint of information to determine what the relationship was, if there was concern that it was intercorporate and therefore not available to somebody?

Did you say that, or did I misunderstand?

Mr. **Wilson**. I did indeed. We have proposed that we submit both the transportation contract and the coal contract to the Secretary, thereby giving him an opportunity to review them, to view them against a complainant's own experience in seeking a transportation contract and his own experience in marketing his coal. And if there's was any difference, any material difference among those, would make them available to the complaining coal company.

Senator **Domenici**. Thank you very much.

Senator **Ford**. I might say the amendments were drafted in an after-the-fact solution which gives them concern.

Mr. Holsten, back to my question.

Mr. **Holsten**. Senator Ford, you've hit it on the head. We commend the group that worked on this. Mr. Wilson was the chairman, was head of that side, and I was the chairman, was head of our side, and the people did some good work on the leasing issues: the disclosure of information, the sharing of information, that's fine.

The problem on the transportation side is twofold. You just said here, it is after the fact that the information would be submitted, the contract would be submitted. That implies that the railroad's mining affiliate and the customer had gotten together and negotiated a contract, the presumption here, long-term contracts that we deal with. It's after the fact.

Our company hypothetically had lost the bid. We've closed our mine. We've laid off our people. And now, after the fact, we're talking about possible identification and remedy. That's one of the problems.

The other problem is that it still doesn't address the monopoly power that the railroad has and the potential for the use of that power in a discriminatory fashion. So that it doesn't address the transportation issue; it doesn't address the remedy part. It doesn't address how damages are assessed. These are all the factors that we wanted to talk to the railroad holding company—and Mr. Wilson is correct—the railroad holding company—because they are beyond the normal area of dialog that we have been dealing with between ourselves and the mineral affiliates.

So the amendments are a step in the right direction, but they don't put to bed some of our basic concerns about the possible conflict of interest when a railroad and its mining company compete against a coal company that then in turn is wholly dependent upon the railroads.

Senator **Ford**. Well, if I am correct in trying to read this procedure, the specifics of this amendment, it sets up a procedure whereby the parent must file with the Secretary of the Interior copies of any contracts entered into for the movement of coal from any lease which they have held.

Now, that's as you say, Mr. Holsten, it's already a fact then. It then goes on to provide a mechanism for any coal producer to file a complaint on the contract. It seems to me that we've put the Secretary of the Interior in a very vulnerable position, because if what you said is true, that the contract is finalized, you're the loser, you close down, and then the Secretary finds that there are discriminatory practices here—that's after the fact—and then we find—I don't see the legal remedies, other than the normal remedy to recover.

And it seems to me that it's putting the producer in jeopardy as I see it because—and you've got at least two steps. They're exempt from the Federal Trade Commission, and ICC says that they have no jurisdiction, really, as it relates to the shipper or the carrier. Therefore, it is possible that a rail carrier could negotiate a contract rate with its mining subsidiary which was significantly lower than the rates charged to other coal shippers. And that's testimony before the Commission.

I think it puts the shipper in a very vulnerable situation.

Do you have any other items that you'd like to talk about? You're willing to accept some modifications rather than outright repeal. The provisions of the transportation in here is something that ought to be discussed. We're in the middle of Staggers Act discussion someplace else, but just like everything else, those who are involved are interconnected; they're related; and every item has to be considered.

You can't just take this one out here and isolate it in discussion, and I think all of it ought to come together. It's very easy to say, you as the head of your company, you can negotiate on one and you can negotiate on the other, but the others begin to shift the responsibility around and you get pitched from pillar to post and never get to those who actually have the authority to make the decision. It's awful hard to get to that point, isn't it, is that what you've found so far?

Mr. HOLSTEN. Yes, sir.

The only other point I want to make is that it is a complex issue. There may be a resolution; I don't know. But being tied to the 1975 act, we're running out of time on the 1976 act. And if some way we can get the two divorced and then sit down and try and resolve our differences here on their own merits, that I would subscribe to, but let's get some relief on the 1976 act. We're out of time on that.

Senator FORD. Senator Domenici.

I have some questions I'm going to submit to the panel in writing and hopefully have a timely response, Mr. Holten.

Mr. HOLSTEN. Yes, sir.

Senator DOMENICI. Well, first let me apologize for being late and also to my Attorney General if he's still here, Attorney General Paul Bardacke. I just could not be here. I was invited to be downtown for about an hour and a half during this meeting and I couldn't get here.

Let me ask Mr. Zitting, Mr. Wilson, Mr. Thompson, this question. First let me say I understand the problem that we have at the Lee Ranch where you have a marvelous new coal mine. I've been there and there are so few new ones occurring that are operative, it was a true pleasure. I was somewhat concerned that even though we didn't use Federal land, Federal leases, Senator Johnston, we have made things so easy that even using private land it only took 12 years.

I wonder what it would have done, had they really wanted to use that checkerboarded Federal land. I assume they wouldn't be open yet. I imagine that you and I might not even be in the Senate any longer.

Senator **JOHNSTON** [presiding]. We don't want to rush into anything.

Senator **DOMENICI**. That's right. I mean, after all, this is dynamite.

But that case, I must say for the record, clearly, clearly presents an issue for 2(c), even if we don't have the other issue resolved. I mean here we have a coal mine in operation, checkerboarded. You look out there and here's this section they can use, State-owned land, right next to its Federal—can't use it because of a 2(c) kind of provision—and over here is another State lease and one of theirs. And we'll have to leave some flexibility in all events to block that out. Nobody else is going to use that, it would appear to me. It's right there. It's on their mining property.

Well, let me say to the three of you, as I look at this, clearly you cannot be saying that you want to operate as a railroad and be in the coal business and not furnish—and not assure us that there is every protection for your coal competitors who are not affiliated with the railroad, making sure that you are not making your properties more valuable by discriminatory rates. I mean there is just—I'm on all your sides, but clearly what we've got to do is we've got to convince everyone that as to Federal land, we can't let that exist. I am not saying it does. It just appears to me that we ought to start with the state of the law and the state of the Federal bidding process and the rights you have as both railroads and mining companies, and we must dispel the notion that in any way we are going to enhance, permit, encourage discriminatory rates for our coal, the Federal Government's coal, for your own use versus one of these companies that's not in the railroad business.

Would you agree with that?

Mr. **WILSON**. Absolutely.

Mr. **ZITTING**. Absolutely.

Senator **DOMENICI**. Now, obviously, they don't think the state of the law is that now or they wouldn't be here, I think. Is that correct, Mr. Holten?

Mr. **ZITTING**. Senator, I don't think they have any real concern in this area. I think they're trying to keep legitimate competitors from competing with them in the coal business.

Senator **DOMENICI**. OK. Well, I'll get to that in a moment. I am not interested in letting them get rid of some competitors—namely you all—if indeed it is competition that we're talking about.

So I would say to this side of the table, if it is your concern that you want them out of your competitive nest, you're not going to get my support unless it's on the issue of discriminatory rates or the providing of rail access in a preferential manner to their properties by them when they're not going to provide it to you and yours by design.

That one bothers me a little. I don't know the answer to that. But that could be the case.

So let me ask you, Mr. Holsten, what are you complaining about? I've just outlined mine. What is your complaint?

Mr. **Holsten**. I recognize the value of your time. In my opening remarks, I tried to say that we're not against this because we want to keep Dick Zitting out of the business. We have the neighboring mine over there at McKinly, and this is a good mine—you're absolutely right. We have sent our people over to look at the mine and to try and brain pick a little bit. It's a good operation.

Lee Ranch was put in, however, on the State and the fee sections, knowing that 2(c) was in effect. It was put in, betting that something could come of 2(c). I have a little difficulty in having them say now, OK, because of 2(c) I can't do this and can't do that.

Senator **Domenici**. But they make it without it.

Mr. **Holsten**. Yes. And I think they can. I think they can. But my complaint is—you know, what's your complaint—my complaint is that it's not vertical integration that I'm complaining about. It's vertical integration with monopoly power. They do have monopoly control and, as Senator Ford said, apparently you can't appeal these things. The ICC doesn't have jurisdiction over discriminatory rates.

It's those concerns that—there may be answers to them. We want to talk about them, but we haven't been able to, and in the meantime we keep coming back to August 4. That's coming up on us.

Senator **Domenici**. But is it discriminatory rates that bother you, that they may be able, both in the bidding process and in the normal operation of their enterprise, as a vertically integrated company, they may be able to discriminate in the bidding and thereafter, and you want some rights; you're not sure what your rights are?

Mr. **Holsten**. We're not sure what our rights are. We would like to have the rights spelled out and the remedy spelled out. Yes. It's discriminatory ratemaking potential. It's the potential for the discriminatory ratemaking and in the marketing of the coal, some sort of a tie-in between the transportation and the market price that is discriminatory to a commercial producer who in turn then is dependent upon the railroad.

So it's in both areas, transportation and marketing.

Mr. **Zitting**. Senator, I'd like to make one little comment about this move to try to separate the two issues and the urgency of it.

At the time we started the Lee Ranch Mine, the position of the Interior Department was that affiliates like ourselves that were really not the alter ego of the railroads, were entitled to hold Federal leases. So we began the Lee Ranch Mine on the basis of feeling we'd have a reasonable opportunity to bid and fill in our block as we went along.

Now, we can mine that coal. We're going to waste a lot of our coal, we're going to waste a lot of Federal coal, we're going to tear up a whole bunch more country out there than we otherwise would have to, but we'll mine the coal. We're going to stay in the business.

But the Justice Department prevailed on the Interior Department kind of in the middle of our project, and we've gotten the change of position to one that said that even though we're just kissing cousins of the railroad, that we are prevented from buying Federal coal leases in the normal manner. So that's one point of it.

As far as the urgency, the Interior Department may well hold the coal lease sale out there before August 4th next year, so I think 2(c) may be more urgent to us than section 3 is to the people who live off of the public coal or the public dole, whichever you like to call it.

So I would object to changing the consideration of these anticompetitive measures which Linowes said needed to be corrected to enhance competition in the coal industry to separate one from the other.

Senator DOMENICI. Could I then ask one last question, and I apologize again for burdening you all.

You want relief from 3 and 7. They want relief from 2(c). In a nutshell, why do you need relief from 3 and 7? I mean is it your position that you would have developed this land, or those who were going to lose their leases for lack of development and lack of diligence, that we did something and the Government has done something that's going to cause this to happen? What is the position?

Mr. HOLSTEN. No, it is neither that we've done something or the Government has done something. It's that something hasn't occurred, and throughout quite a few of the remarks there's been a lament that leases haven't been developed. It's not that leases haven't been developed. That's not the problem.

The problem is that markets haven't developed. These leases will be brought into production just as soon as you can get them to market. You're not going to open up a coal mine—Mr. Zitting wouldn't, Mr. Wilson wouldn't, Mr. Thompson wouldn't—without first having a contract. There's too much money tied up in these mines. So you have to get the contract. To get the contract, you have to have the lease; to have the lease in turn engineered, developed, and ready to go. The market has slipped. Hence, now we have a surplus of coal under lease that hasn't been developed.

We don't make any money, none of us do, just holding leases. The money is made in bringing them into market and selling them.

Senator DOMENICI. But are you suggesting that somehow Congress should have had in mind when it passed these laws and the proceeded, implicitly or explicitly, to put huge amounts of coal on the market—which I'm not against—I don't buy the notion that you've got to develop it next week and if you hold it, if you get it for a good price, we ought not put any more out there till it's all developed. I think that will never work, we trying to microplan the industry.

But did we think you all would really be using it when we passed these? Were we kind of crazy to think that you would have to have had all this coal under some development? I don't believe you all believe that you could have had this coal under development within the time prescribed in the law, with markets. Do you?

Mr. HOLSTEN. I don't know. I think there's probably a yes and no answer to the question. Certainly the outlook for the energy industry—in Senator Johnston's home State, the oil and gas—nuclear power, the demand for energy. There was a euphoria back in the midseventies and possibly it was in anticipation of that that all of these leases were put out, or the leases back in the sixties even. It was just in an anticipation of what's going to come—and, unfortunately, in hindsight we're pretty smart.

And that's also true of some of the investment decisions that our own companies have made.

Senator **Domenici**. So that the provisions of the law that might have expected you to be much further along the line on develpment, looking back on it, just probably wasn't going to happen for a lot of reasons. Is that what you're saying?

Mr. **Holsten**. I think so.

Senator **Domenici**. Thank you.

Senator **Johnston**. Thank you, Senator Domenici.

And, gentlemen, I also want to apologize for not being here for the early part of your testimony. You were all singing the same song, being part of that happy fraternity of coal producers.

Mr. **Holsten**. We're all competitors.

Senator **Johnston**. If it makes you feel any better, I don't know of anybody who has successfully, correctly forecasted any trend in energy over the last 10 years. Not one single trend has been correct.

I was just meeting with Senator McClure, just a moment ago, to deal with the wreckage of the Synthetic Fuels Corporation which proudly came out of this committee, and they had the big ceremony out on the White House lawn. They were going to provide much needed energy through synfuels. I still happen to believe we ought to do that, but the rest of the Congress thinks not. In any event, the price and supply structure that we thought would be superimposed in the mideighties didn't turn out that way.

We've missed almost every trend there is, and, I think, if I can make one prediction—which is probably worth what all the other predictions are worth, but I still believe it—and that is that the crunch is going to come on us sooner and more virulently than most people expect, brought on to a large extent by the euphoria we have right now.

People are just shutting down the drilling of oil and gas wells. They're not mining coal and now closing down nuclear plants and all the rest. But I know I'm preaching to the choir on that.

I would like to make one observation, and that is that this Congress is a lot further along than most people would think. Most people would think, well, we're not even through the first year of a 2-year Congress and there's lots of time left to do whatever you want to do.

The fact of the matter is, there really is not. For a bill that is still in hearings now, which is a very controversial bill, and this set of bills and this set of issues is highly controversial—this legislation could be caught by the timeclock. Incredible as it seems, we're probably not going to be able to do anything much the rest of this year. We've got our plate full certainly on the floor, and I doubt if we have time to deal with this and markup in this committee this year. Maybe we do, but we wouldn't be able to do too much of anything else. And I know we've got the Low-Level Nuclear Waste bill that's controversial and that's going to take up a good amount of time.

And so I would hope that we could, frankly, deal with the problem of the nonproducing leases. I think to have these leases canceled would be a terrible thing to happen. The situation is really not the fault of the companies, but instead is the fault of the energy situation having come on as it did, and no one, not the Government, not anyone, saw that it was coming.

And I think we ought to deal with that and go ahead and deal with it this year.

In the meantime, I would hope that railroads and coal companies could get together on these matters. It's probably a vain hope because you've got Staggers. Also, you've got an issue there that I'm quite interested in—coal slurry pipeline. You know, if we had a coal slurry pipeline system in place, then 2(c) would not be so bad.

But let me start off by asking that question. Mr. Zitting, how would you feel about a tradeoff of 2(c) and coal slurry pipeline situation?

Mr. ZITTING. Well, you're asking me transportation questions again and you're talking to a coal miner. As a coal miner, I guess I'm happy to see my coal moved as far and as cheap as it can get to get to market. And so if a coal slurry pipeline accomplishes that, fine with me.

As an engineer, I know that the only possible chance for coal slurry pipelines to ever be feasible is if it's a large volume movement from point to point where the point of origin has a lot of excess water they want to send to somebody, and I don't see that being the case in most instances in the West where I operate. You're talking to a—I'm a railroad affiliated company, but I'm also a coal slurry pipeline affiliated company. One of our affiliated companies operate the only commercial coal slurry pipeline in existence today out of Black Mesa in Arizona, and I know our parent company would be happy to find other opportunities in that industry.

So if that answers your question, that's the answer I can give you.

[Pause.]

Senator JOHNSTON. Gentlemen, I'm sorry. I thought all of you had testified. I'm advised that some of you had not had your testimony in chief yet. Maybe you would like to give the testimony on section 3 at this point before I go forward with any further questions.

Senator DOMENICI. Bennett, would you yield for a moment?

Senator JOHNSTON. Certainly.

Senator DOMENICI. First I want to associate myself with your remarks as they pertain to predictions. I think you're absolutely right; we're going to have a crisis and it's going to fall on us. I do, since you would like to really cloud this up with coal slurry, while I have the coal companies here I'd like to get the Fuel Use Act repealed. [Laughter.]

Senator JOHNSTON. Great idea.

Senator DOMENICI. So we can use more natural gas. And maybe if we're going to have a little interrogation, we'll ask the coal companies how they would look on total elimination of the Fuel Use Act. We might have just one great big basket of goodies and might get it all passed, and if we keep delaying reconciliation 2 or 3 more weeks on the floor, we can draw that up and put it on there and we won't even have debate.

Senator **Johnston**. If you'd allow me to interrupt, would somebody put a cold towel on Carl Bagey's head back there? [Laughter.]

Senator **Domenici**. I did notice his pipe stopped smoking.

Mr. **Holsten**. But we do have him muzzled.

Senator **Johnston**. Let's see. Who is next on the list to testify?

Mr. **Holsten**. Senator Johnston, Mr. Winterer of Utah International.

STATEMENT OF T.R. WINTERER, SENIOR VICE PRESIDENT AND MANAGER, U.S. MINING OPERATIONS, UTAH INTERNATIONAL, INC.

Mr. **Winterer**. Mr. Chairman, Senator Domenici, my name is Tim Winterer. I am the manager of U.S. Mining Operations for Utah International, a San Francisco-based mining company with exploration and mining activities around the world.

We're one of the earliest participants in the development of western coal and we still have substantial western coal reserves on Federal leases that——

Senator **Johnston**. Try and pull that mike a little closer there.

Mr. **Winterer** [continuing]. That we're anxious to bring to development, bring into production.

By our testimony we hope to demonstrate both the need for legislative relief and the unrealistic nature of the current production requirements, particularly when applied to Federal coal leaseholders who have diligently attempted to develop those leases.

Current law attempts to compel production from existing Federal leases in several ways, one of which is section 3 of the Federal Leasing Amendments Act of 1975 which was referred to by Mr. Holsten. The current statutory requirements were born out of the mistaken notion that billions of tons of Federal coal under lease are available to the market, and the coal industry merely needs to be prodded through such devices as specific requirements for minimum levels of production to start the flow of coal into the marketplace.

That notion is mistaken for several reasons. First, as Mr. Holsten said, the coal does not get produced unless there's a market for it. In recent years, energy conservation efforts have significantly reduced the rate of utility load growth with a consequent decline in demand for all energy fuels. Coal is but one, competing in the energy marketplace with oil, gas, and uranium.

Moreover, in the coal markets, coal deposits compete on the basis of site-specific factors such as availability of transportation, distance from markets, coal characteristics, and environmental considerations.

Delays occasioned by Government action and inaction, as well as actions of third parties, also play a role. Many constraints develop or happen over time and few are well understood when the Federal lessee first secures his coal lease.

I would like to briefly sketch for you two instances where, despite our diligent efforts to achieve commercial production, we have so far been unsuccessful. We have a property in northwestern

Colorado called Danforth Hills. In 1964, our company secured a coal mining lease from the State of Colorado on State lands in the area, and the following year obtained two prospecting permits on adjacent Federal lands. Following drilling on one of the permits, a Federal coal mining lease was issued to us in 1966.

In 1968 we applied for a preference right lease on the second permit area, but the application for lease was denied by the BLM. In 1970 that decision was reversed, but the lease was not issued in time to avoid the 1971 moratorium on Federal coal leasing.

In 1977 we resorted to filing suit in Federal court, which upheld the issuance of the preference right lease. At the time of filing the suit, we had expended approximately $1.7 million in developing the property.

In 1978 we continued drilling and environmental studies in preparation for a mine permit application. In 1979 we submitted to Public Service Co. of Colorada, a proposal to furnish coal from the deposit to one of their powerplants, conditioned upon our obtaining the preference right lease. That bid was not accepted.

In 1980 the Federal District Court in Colorado ordered the Interior Department to issue the preference right lease. However, this order was appealed and thereafter our company and the Interior Department conducted negotiations which finally resulted in the settlement of the litigation, issuance of the lease to us in 1982.

During all this time we have continued drilling and engineering work in the development of environmental programs for the entire reserve. To date, we have expended approximately $3 million on these properties, not counting the amount paid to the Government as the bid for the issuance of a new competitive lease in 1982 which added to our reserves.

The project includes three Federal leases, one State lease, one private lease, and has reserves of over 300 million tons.

Danforth Hills is a deposit that has been planned and engineered to a point where it is participating in the competition for new sales to the electric utility industry. It has taken 20 years to get to that point.

The other project I'd like to mention is the Alton project, a coal field in southern Utah. We hold reserves there consisting of 19 Federal mining leases, 4 State mining leases, and 6 mining leases on fee properties, containing in total approximately 250 million tons of reserves in place.

We commenced our acquisition of Federal and State leases in the area in 1963. During the midsixties we conducted drilling and engineering work and acquired water rights for the project. In 1967 we prepared a feasibility study and attempted to market coal as a fuel supply for the Navajo Generating Station at Page, AZ. These efforts were unsuccessful.

In 1969 Utah International and Nevada Power Co. began consideration of a joint development in connection with a plant to be sponsored by Nevada Power Co., and this eventually led to discussions of various electric utilities interested in the development of the Allen Warner Valley Energy System.

In 1974 the Allen Warner Valley project was announced with Alton Coal designated as the preferred fuel supplier. This led to extensive additional drilling, coal preparation tests, water test wells, and the preparation of an environmental assessment.

In 1979 an environmental impact statement was issued and a petition was filed by environmental groups to declare the lands included in our various leases as unsuitable for mining under the provisions of the Surface Mining Control and Reclamation Act of 1977.

In 1980 the Secretary of the Interior declared a portion of the coal field unsuitable for surface mining. In 1981 Utah International and others filed suit, challenging the decision of the Secretary on unsuitability.

In 1982 Utah International made application to the State of Utah under the Surface Mining Act for a permit to operate the coal mine. During 1983 and 1984, there were continuing delays in the unsuitablity litigation and processing of the mine permit application.

As of now, most of the outstanding claims in the litigation have been dismissed, and it is our feeling that the deposit constitutes a viable mining reserve which will be brought to market as the need for electric power in the Southwest continues to grow.

To date, we have spent 22 years and $6 million in work on this property. We think these two examples illustrate the complexities and difficulties associated with packaging for the Western coal markets: Coal reserves under various ownerships, water rights, required permits, and entitlements. I also think these examples point out the substantial role the Government played in the delays we have experienced.

Federal coal leases issued prior to 1976 were issued under the 1920 act which required diligent development. For 50 years following enactment of the 1920 act, the Government never asserted that diligent development required production of any particular amount of coal. Rather, it should require bona fide efforts to develop.

Section 3 and the other production requirements of the Mineral Lands Leasing Act impose unrealistic, inequitable deadlines on Federal coal lessees, penalize those who have made good faith efforts to develop their leases, but have not been able to produce from those leases because of lack of markets, because of Government action or inaction, because of the actions by third parties.

Thank you.

The **CHAIRMAN** [presiding]. Thank you.

Mr. Mahaffey.

STATEMENT OF JACK MAHAFFEY, PRESIDENT, SHELL MINING CO.

Mr. **MAHAFFEY**. Mr. Chairman, I'm Jack Mahaffey, president of Shell Mining Co. My company does not face an immediate section 3 problem because of our two pre-1976 lease holdings. One is producing, and the other acquired by assignment, has not been held by Shell for the 10 years.

However, a third newly acquired lease, Spring Draw, has been tied up in litigation since 1982, 3 years of the statutory post-1976 10-year section 7 lease diligent development period. For this reason, I'd like to concentrate my remarks on section 7.

First of all, I'd like to say that the coal industry does not object to the principle of diligent development. Diligent development to assure that Government resources are produced on a timely basis make sense. However, strict requirements for coal lease production by a certain date ignores the very heart of the problem. And that's finding a market and being able to produce the reserve at a competitive price.

The Federal Coal Leasing Amendments Act impose strict development requirements. The coal industry feels that it's imperative that the statute be amended to afford more flexibility in meeting this diligent development requirement and inflexible mandate to achieve full commercial production 10 years after lease issuance is extremely unrealistic.

Mr. Chairman, there is simply no way to assure that full production on a lease will be achieved in 10 years. This risk reduces the lease value and, hence, affects the values placed during Federal lease sales and it risks reduced revenues to both Federal and State Governments.

When a company bids on a lease, it rarely has a customer for the coal. Leases are inventories of coal, quantity and quality, at a location suitable for delivery to potential customers. Producers need to be able to inventory a sufficient number of leases which vary as to type and quality of coals to meet different and often changing buyer requirements. The marketplace will determine which leases will be developed and which will revert back to the lessor.

Testimony presented to this committee over the last few years has suggested that it often takes anywhere from 12 to 14 years to develop a large Western surface mine. This effort includes assembling a mineable coal package, market development, environmental and related studies, design and construction of the mine, permit acquisition, mining preparation, production buildup, and then finally coal production.

Let me note some of the more important time-consuming environmental protection steps which, for the most part, were passed or fully implemented after passage of the 1976 Leasing Act: The Surfacing Mining Control and Reclamation Act of 1977; extensive environmental performance standards addressing such areas as industrial siting, fish and wildlife, air quality, water quality and postmining land use; preparation of an environmental impact assessment or statement; the Clean Water Act; the Clean Air Act; the Endangered Species Act; and the various archeological and historic preservation acts; some statutes and regulations governing mining operations.

There are different approaches to providing flexibility to the now inflexible diligent development requirements of section 7. Our preferred approach is simply to extend the time period perhaps an additional 5 or even 10 years through payment of advanced royalties, an approach adopted by both Senate bills 570 and 372. These bills address this problem by providing flexibility in the application of the diligence standard, while maintaining a strong incentive to develop the leasehold.

We strongly urge adoption of such a provision.

That concludes my remarks. Thank you.

The CHAIRMAN. Thank you very much.

Mr. Ewing.

STATEMENT OF WAYNE EWING, PRESIDENT, PEABODY DEVELOPMENT CO.

Mr. Ewing. Mr. Chairman, my name is Wayne Ewing. I'm president of Peabody Development Co. which is a wholly-owned subsidiary of Peabody Holding Co., which is the Nation's largest coal producer. And on behalf of Peabody, I want to express my appreciation for the leadership of this subcommittee in dealing with these complex issues of Federal coal leasing.

From Peabody's perspective, the Federal Coal Leasing Amendments Act is in need of revision in several areas in addition to those cited by my colleagues. A brief mention of Peabody's extensive efforts to comply with section 3 will underscore the need for amendment.

Peabody was listed as the largest single holder of Federal coal leases 7 years ago, most of which were undeveloped. By the end of this year, all of our pre-1976 Federal coal leases which Peabody continues to hold will be part of ongoing coal mining operations and therefore, by any reasonable standard, are being diligently developed.

However, because of absolute initial production requirements and our lease configuration problems, Peabody finds itself in technical but not substantive noncompliance with section 3. So, despite detailed planning, diligent marketing, construction and, in some cases, relinquishment of leaseholds, Peabody may be barred from obtaining any additional Federal mineral leases under the Federal Coal Leasing Amendments Act unless this act is amended.

We therefore urge the Congress to repeal section 3 as is suggested in Senator Wallop's bill. In the event that outright repeal is not possible, we seek modification of section 3 in at least two areas. No. 1, acceptance for purposes of compliance with section 3 of actual production of coal under bona fide contracts, even if production from these leases has not reached the cumulative level required in section 7. And No. 2, provisions of mechanisms for issuance of new coal leasers to holders of undeveloped leases through the payment of noncompliance penalty.

Senator Johnston's bill suggests a penalty payment in the form of either relinquishments of leases containing comparable coal tonnage to leases or leases being issued, or a special penalty rental payment on any new lease issued to a noncomplying lessee. Peabody accepts these modifications of section 3 proposed in S. 372, although we continue to believe that repeal of the entire section 3 would be the most workable solution.

We would suggest that a provision be added to this bill which would render those leases or logical mining units that are in production and under contract to be exempted from any section 3 sanctions. By any standard of reason, penalties applied to Federal coal leases which are in production and under contract are inappropriate.

Another area of concern of ours is contiguity of logical mining units. section 5 of the Federal Coal Leasing Amendments Act of 1976 provides for the establishment of logical mining units. This provision allows for the consolidation of Federal, State, and fee coal properties into a single unit or operating mine. It also requires that all properties contained in such a logical mining unit be contiguous.

One Peabody mine located in Colorado contains six Federal coal leases, as well as other properties. This mine is divided into three areas, separated only by two narrow quarter-mile strips of land which Peabody, for a variety of reasons, has been unable to obtain or control. As a result, these three areas cannot be incorporated into a logical mining unit because they are not technically contiguous.

Peabody is currently producing coal in one of these areas. In 1986, we plan to bring production on in a second area. However, to bring production on in a third area in the timeframe required by section 3 is not possible with the existing equipment that we apparently have at the coal mine. Also, the surface mineable production from all these areas is committed by contract to be delivered to a mine mouth powerplant and the current requirements of that powerplant do not presently warrant the disturbance in the third area.

Further, if we had to add additional equipment to open this third area just to bring ourselves into compliance, it would substantially and negatively affect the economics of the entire mine.

I might add, Mr. Chairman, that the properties were obtained and the mine was constructed and operating well before the enactment of the Federal Coal Leasing Act of 1976. We seek amendment such as proposed in Senator Wallop's bill which would permit noncontiguous properties within reasonable proximity of one another to be included in single logical mining units. Such an amendment would allow for the formation of a noncontiguous logical mining unit where geographical or legal anomalies prevent the physical continuity of the included properties.

Also under the 1976 Federal Coal Leasing Amendments Act, an operation and reclamation plan is required to be submitted within 3 years of the issuance of a new lease. For several reasons, this requirement in section 7(c) is no longer pertinent and should be repealed.

First, it was effectively superseded by the enactment of SMCRA in 1977 which mandated the submission of a far more detailed and comprehensive plan prior to the approval of the required permit for a mine.

Second, it's inappropriate and untimely to develop a mine plan before a market has been found, and the level of demand for production from the leasehold or logical mining unit has been determined. In many cases it's impossible to make such a determination within 3 years of the lease issuance. We encourage this subcommittee to support the repeal of this unnecessary and unrealistic provision.

Another area, the exhaustion of reserves within a 40-year period, the Federal Coal Leasing Amendment Act requires that we mine out an area within 40 years, and Peabody believes that this requirement is unwarranted. Under section 7 of the Federal Coal Leasing Amendments Act, the lessee, after attaining production in commercial quantities, must maintain annual production at a level of 1 percent of the recoverable reserves of the lease or logical mining unit, computed on a 3-year rolling average. The 40-year requirement of section 2 is therefore unnecessary and could create operational and regulatory difficulties.

In conclusion, Mr. Chairman, I want to reiterate three basic points which we believe are pertinent to this hearing. First, there is an obvious need to repeal or modify section 3. When a lessee such as Peabody has made every reasonable effort to be diligent in development of its leases, yet finds itself still penalized by inappropriate or inflexible statutory diligence requirements, then the law needs to be changed.

Second, there are provisions of the Federal Coal Leasing Amendments Act which are no longer appropriate to realities of the coal leasing program to the current coal market. The necessity of acting now on section 3 issues presents an opportunity to redress these inappropriate and unnecessary provisions.

Finally, Mr. Chairman, we believe that the subcommittee should be cognizant of the effects of subsequently enacted laws, notably SMCRA, which render some of the provisions of the Federal Coal Leasing Amendments Act needless and duplicative. In this context, we believe the Federal Coal Leasing Amendments Act can be amended without any detriment to the environment or the management of the public's resources.

Thank you very much.

The **Chairman**. Thank you, Mr. Ewing.

Mr. Brown.

STATEMENT OF B.R. BROWN, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, CONSOLIDATION COAL CO.

Mr. **Brown**. Mr. Chairman, my name is B.R. Brown, chairman and chief executive officer of Consolidation Coal Co. Let me begin by reviewing our situation with regard to both Federal and non-Federal reserves. We hold 12 billion tons of coal reserves nationwide, of which about 10 percent is Federal coal. Consolidation operates more than 20 mines in the State of Virginia and West Virginia. We continue to invest in new mine capacity.

We also hold uncommitted coal reserves that we have held for 50 or 60 years, but it would be incorrect to conclude that we have no interest in developing its coal holdings, as our capital investment record demonstrates.

Not every reserve can or even should be developed in a short period of time after it's acquired. The speed with which a reserve is developed depends on how well it matches with market demand. We look at reserves in terms of their long-term strategic value to the company. We try to assure that we have an adequate inventory of uncommitted reserves to match the future demands. That requires us to acquire and hold different coal reserves in a variety of locations.

If we're forced to relinquish our pre-1976 Federal coal reserves, we lose more than their strategic value. We have invested more than $8 million in these leases for exploration and environmental work. In addition, we have invested countless man-hours in defining the nature of the reserve and developing mine plans.

From the time the lease is acquired, we develop the best geological, engineering, and environmental data that we can about the reserve. This helps our marketers match customer requirements with the reserves that we hold. Of course, this doesn't guarantee a sale, but it's a tremendous expenditure of human resources which will be wasted if we're compelled to relinquish these reserves because they have not been developed in time to meet the arbitrary deadline.

S. 372 limits the effect of section 3 on coal. I support that change.

Second, the section 3 prohibition would be triggered only when a company acquires a new coal lease. This overcomes several dilemmas. It means that the Department of the Interior would not be precluded from issuing preference right leases to applicants with undeveloped pre-1976 leases or issuing leases pursuant to congressionally mandated exchanges.

Third, the Johnston bill provides two methods for a holder of nonproducing pre-1976 leases to qualify for future lease sales. The first method to qualifying is to relinquish or turn back from your pre-1976 leases a number of tons of coal equal to the number of tons you receive in a new lease.

I believe it would be simpler to establish the turnback on an acre-for-acre basis.

Let me add as a final footnote to the turnback concept that it is not an exchange. It is a transaction in which the Government receives fair market value for the new leases. It offers and imposes, in addition, a penalty on the lessee if that lessee still holds undeveloped pre-1976 leases. The penalty, of course, is the relinquishment of leases by the lessee earlier than the lease terms would otherwise require.

In an exchange, conversely, the Government merely trades leases with the lessee without receiving any additional bonus bid or without imposing any penalty on the lessee.

The other option provided for in the Johnston bill for qualifying for new leases is to pay an additional annual rental on the coal being acquired. The concept is similar to that of relinquishment, in that the Government receives fair market value for the lease it offers and then imposes, in addition, a penalty in the form of additional rentals as the price the lessee must pay for continuing to hold undeveloped pre-1976 leases.

I believe that this is an acceptable option. The provision limiting this option to lessees holding no more than two noncomplying leases unfortunately restricts the flexibility otherwise provided for the bill, and I believe that that should be deleted.

Thank you.

[The joint statement of Mr. Holsten, Mr. Brown, Mr. Ewing, Mr. Mahaffey, and Mr. Winterer follows:]

NATIONAL COAL ASSOCIATION

TESTIMONY OF

RICHARD M. HOLSTEN
PITTSBURG & MIDWAY COAL MINING COMPANY

B.R. BROWN
CONSOLIDATION COAL COMPANY

WAYNE EWING
PEABODY DEVELOPMENT COMPANY

J.L. MAHAFFEY
SHELL MINING COMPANY

TIM WINTERER
UTAH INTERNATIONAL

on behalf of

THE NATIONAL COAL ASSOCIATION

THE AMERICAN MINING CONGRESS

THE MINING & RECLAMATION COUNCIL OF AMERICA

before the

SUBCOMMITTEE ON NATURAL RESOURCES DEVELOPMENT
AND PRODUCTION

UNITED STATES SENATE

November 8, 1985

Mr. Chairman and members of this Committee, I'm Richard Holsten, President and Chairman of the Board of The Pittsburg & Midway Coal Mining Co. in Denver, a subsidiary of Chevron. With me are four of my colleagues from the coal mining industry. Tim Winterer is Senior Vice President and Manager, U.S. Mining Operations, Utah International, San Francisco; J.L. Mahaffey, President, Shell Mining, a subsidiary of Shell Oil Company in Houston; Wayne Ewing, President, Peabody Development Company St. Louis, a wholly-owned subsidiary of Peabody Holding Company, Inc.; and B.R. (Bobby) Brown, Chairman and CEO, Consolidation Coal Company, Pittsburgh. Together, we are appearing on behalf of the National Coal Association, the American Mining Congress and the Mining and Reclamation Council of America.

The companies represented here are engaged in all phases of the coal mining business, with extensive operations in the western U.S., midwest, and the east, including operations on both federal and non-federal lands. We are delighted to be here to give the industry's view on legislation introduced in the Senate to deal in a comprehensive and substantive manner with the Mineral Lands Leasing Act of 1920, and in particular, the Federal Coal Leasing Amendments Act of 1976 (FCLAA) which significantly changed the 1920 Act.

Western coal production and, in particular, production from federal coal lands has risen dramatically in recent years. Access to large amounts of low priced western coal is increasingly providing the basis for a more competitive industry. As a result, western coal production also provides a basis for limiting the growth in national energy prices. However, about 80 percent of western coal reserves are owned or controlled by the Federal government, and collectively, the Mineral Lands Leasing Act and the regulations governing the leasing of the federal coal are critical factors affecting whether and at what rate most western coal is produced.

In considering amendments to FCLAA, it may be helpful to review the background leading to its enactment, both in political and economic terms.

In the late sixties, a very large number of federal leases and prospecting permits were issued; over 9 billion tons of coal rights were conveyed in the years 1965 to 1970. Relatively little production -- some 20 million tons in 1970 -- was occurring from these leases as leaseholders sought to develop markets for coal that, generally speaking, had far different characteristics than most coals traditionally sold for steam-electric generation. Among other things, the apparent disparity between the number of outstanding leases and the level of production from those leases created sufficient public concern to bring about a federal coal leasing moratorium which began, in effect, in 1971 but which became official in 1973. However, with the onset of the Arab oil embargo, this nation began to place increased emphasis on the use of our abundant coal reserves, and in 1974 the government began to put together a new federal coal leasing program. In this time before the enactment of the Surface Mining Control and Reclamation Act, there was a perception that somehow coal development in the West would be rife with lease speculation and careless mine operation. The reality was quite different. The coal states in the West developed their own stringent reclamation requirements and the leaseholders were either in production, waiting for the construction of powerplants or gasification facilities capable of using the lower Btu-quality coal, or waiting for issuance of new federal leases to complete logical mining units in order to market their coal.

It is against this backdrop that FCLAA was enacted. Today, the situation is different. Production from federal leases has steadily increased -- from 55 million tons in 1976 to 105 million tons in 1983, but the increase has not been as dramatic as the doomsayers predicted. New powerplant construction has tapered off, and is now almost non-existent. Moreover, unfettered rail-rate increases have made long-distance coal haulage unattractive, thus shrinking the serviceable market area for coal from federal leases, especially those in the West. As a result of these factors, the pattern of federal coal lease development over the past decade has been one of tempered, orderly growth. We urge the Congress to review FCLAA in light of today's reality and not yesterday's perception.

Since the enactment of the FCLAA, the coal industry has been intimately involved with the development of the various sets of complex and highly technical regulations that have been set forth by the Department of the Interior (DOI) in its several attempts to implement this Act. Moreover, the industry has been learning a great deal about the realities of western coal production as well as the marketing of western coal.

Based on this involvement and the deeper understanding of western coal production and marketing, the industry, upon careful reflection has determined that certain provisions added by the FCLAA to varying degrees: (1) are unnecessary; (2) impact the wrong parties; (3) could cause serious disruption to western coal development both with respect to particular producers and the West in general; (4) may fail to achieve the goals for which the provisions were enacted; and finally, (5) may foster the problems the Act was designed to cure.

The underlying force behind the FCLAA was its so-called "diligent development" requirements — requirements that certain actions with respect to federal coal leases take place by a time certain. The heart of the diligence requirements are Section 3 and Section 7 of the 1976 Act. By now, everyone on this Subcommittee is aware that Section 3 precludes the holder of undeveloped coal leases issued before August 4, 1976 from obtaining new federal coal leases after August 4, 1986 so long as the company holds and has held these undeveloped pre-1976 leases for 10 years. This provision has also been interpreted by the Department of the Interior as precluding the acquisition of any new on-shore federal mineral leases (oil, gas, phosphate, etc.) as long as the company or its affiliates hold coal leases that violate Section 3. Section 7 simply says federal coal leases issued after August 4, 1976 must be in "commercial quantity" production within 10 years or be cancelled.

Section 3 clearly poses the most immediate and serious threat to the continued orderly development of federal coal, and dealing with it is a major feature of the bills introduced by Senators Wallop and Johnston. It affects each company, including mine, in different and often subtle ways. In order to share with you those impacts and the impacts of other portions of the '76 Act, we have organized our presentation as follows:

> Tim Winterer will elaborate, from his company's own experience, the general problems encountered when trying to bring a western mine into production, particularly involving federal coal;
>
> Jack Mahaffey, whose company not only holds and mines from a pre-'76 lease, but also has acquired a post '76 lease, will focus on Section 7 requirements in today's environment;
>
> Wayne Ewing will address Section 3 in general and his company's particular problem with it, in addition to the other problems with the 1976 Act that are addressed by S. 570 and S. 372;
>
> Bobby Brown will address his Section 3 problem and the industry's position with respect to the various legislative solutions to the problems discussed today.

Mr. Chairman, I would also ask to include a written statement of Mike Bowlin, President of Anaconda Minerals which gives yet another twist to the Section 3 story.

Before commencing our discussion of these coal leasing issues, we would like to discuss Section 2(c) of the Mineral Lands Leasing Act of 1920, and to comment on the proposed amendment to that section recently introduced by Senator McClure.

Section 2(c), which prohibits railroads from being awarded or holding federal coal leases, reflects past Congressional concern over the potential for discrimination when a single entity produces and transports its own coal into the commercial market.

Congress recognized the abuses that could and had arisen from permitting a railroad to act both as a seller and transporter of coal. The legislators responsible for passage by the House of the predecessor of Section 2(c) in 1914 made clear the Congressional intent to "divorce transportation from production" and that Section 2(c) represented the "generally accepted...policy of the country...," to prohibit common carrier railroads from competing with customers forced to ship over their rail lines. As Congressman Raker stated:

> "...to permit them to enter the business of transporting coal other than to run the railroad is just what the trouble has been in the East, where railroads have been permitted to be both transporters and shippers and handlers of coal."
>
> "We have the proviso (Section 2(c)) that they can not handle the coal for the purpose of shipping — in other words, being producers of coal and at the same time having a monopoly over the transportation—"

See Cong. Rec. H15178 (Sept. 15, 1914).

Congressman Stafford summed up the 1914 concensus as reflecting the:

> "generally accepted...policy of the country...to separate the railroads as common carriers from any other activity."

Congressman Ferris added:

> "we are trying to divorce transportation from production, and I think everybody agrees that that ought to be done."

Cong. Rec. H15180, 15181 (Sept. 15, 1914).

Over the years Congress has, on a number of occasions, considered modification or repeal of 2(c) but in every instance has concluded that the potential for discriminatory abuse has outweighed professed benefits.

Nevertheless, in response to the request of Senator McClure, representatives of western coal producers and those of the mineral affiliates of the three major western railroads have met on several occasions this past summer to identify problems that could exist should Section 2(c) be repealed and then to explore legislative solutions to these problems that would be acceptable to the coal producers and the railroads. Those discussions are not concluded. The coal industry has been and continues to be willing to pursue the discussion of legislative solutions to the Section 2(c) issue. However, our initial discussion with the minerals affiliates have now reached the point where participation of the railroad parents and their transportation affiliates is essential. The 2(c) issue is broader than merely mineral leasing concern. If Section 2(c) is to be repealed as the railroads or their minerals affiliates advocate, the transportation issues involved are at the heart of the problem and any proposed solution. Significant anti-trust issues are also involved. These are matters that only the railroad parents can address. Unfortunately, despite several requests we have not yet been able to arrange a meeting with the railroad parent or their transportation companies to pursue possible legislative solutions.

Let me make clear at the outset that the coal industry has no objection to the entry of additional competitors into the business. There are literally thousands of mining entities and dozens enter and exit the industry each year. However, in the case of the three railroad affiliates that have been urging repeal or modification of 2(c), we are not talking about simply three more mining companies.

These three entities are wholly owned by the railroad holding companies who, through their transportation affiliates, provide virtually the only means of transporting coal in their exclusive service areas. Two things are a fact of life in western coal mining. First is the utter dependence on the railroad to move the coal to market. Ninety-eight percent of the western coal moves by rail, and most markets are located hundreds or thousands of miles from the mine sites. There are no alternatives. Waterways are non-existent, and trucks are impractical.

Second, the railroads have virtually complete monopoly power over rates and terms of service in their respective exclusive service areas. While there may be some regional competition, there is no competition in transportation within their exclusive service areas. No one disputes this. Not the Justice Department or private economists who have studied the question.

Furthermore, these monopolies are virtually free of effective government regulation. While the Staggers Act contains protections for captive shippers, the ICC's implementation of those protections have been virtually without substantive meaning. A final fact is that these western railroads are the largest private owners of coal in the west, only surpassed by the federal government iself.

The crux of the policy issue is whether it is sound public policy for Congress to repeal at this time a statute which has been on the books for over 70 years and permit the railroads to compete with coal companies over whom they have unregulated monopoly transportation power. The answer is an emphatic no, at least without making substantial changes in the Staggers Act and the anti-trust laws, to provide effective protection against this monopoly power. Section 2(c) prevents formation of a vertically integrated entity with monopoly power over a key link in production and distribution of the product. The coal industry has long maintained that the issue is not three more coal companies. These railroads should be free to lease federal coal, but outside of their exclusive transportation service area.

The major criticism of 2(c) is that it "locks up" the vast railroad and government coal reserves in the "checkerboard." Let me be perfectly clear -- these reserves can already and should be developed. They can be leased to independent producers with the railroads holding a royalty interest in the coal, just as any other private entity does. Ironically, the hope of 2(c) repeal is, I believe, a reason why this coal is largely undeveloped. So long as 2(c) repeal is held out on the table, the railroads may believe they need not lease their coal now but can wait for repeal.

Our concern with any modification of 2(c) is essentially this: unfair competitive advantages or monopoly power in -- leasing, transportation and marketing. In the area of coal leasing, the railroads have a preferential position in checkerboard areas, where they control alternate land grant sections. This preferential position could, for example, manifest itself in geologic knowledge not available to a competitive bidder. It is in this area, that of leasing concerns, that the operators and the mineral affiliates of the three western railroads have made some progress in their discussions this summer and all of us here at this table commend them for their efforts.

However, it is in the other two areas, transportation rates and marketing that the real concerns of the coal industry exist. The Staggers Act has made these problems more serious and complex. Given the flexibility now afforded the railroads under the Staggers Act, there is little assurance that a railroad would not give its minerals affiliate a more favorable freight rate than that offered a neighboring commercial coal producer with similar requirements. Even assuming comparable freight rates are quoted by the railroad, what assurance is there that there would not be an unfair allocation between the quoted freight rate and the affiliate's mine price so that most of the railroad's total profit for the two functions, mining and transportation, would be allocated to the freight rate. In that instance the inflated freight rate would be offered to both the commercial producer and the railroad's minerals affiliate; the affiliate's mine price could then be quoted at breakeven or a low rate of return compared to the commercial producer's inclusion of a normal return on investment. For example, assume a price of twenty-five ($25.00) dollars f.o.b. for coal and a ten ($10.00) dollar freight rate would provide a fair rate of return to a railroad and its minerals affiliate, Company A. Assume also that Company B, a coal company in competition with Company A, is dependent on the railroad to transport its coal to its customers. The railroad could raise its freight rate to $15.00 per ton and reduce the f.o.b. price for Company A's coal to $20.00 per ton. The delivered price to the customer would be the same. But, the delivered price for Company B's coal would be increased by $5.00. Since coal is bought by the consumer on a delivered cost basis -- mine price plus transportation cost -- the commercial producer's bid would be noncompetitive due solely to an internal allocation of profit between the railroad and its mining affiliate.

This is not simply a hypothetical possibility. For example, the advent of competition among railroads in the southern portion of the Powder River basin has reduced shipping rates for coal from that area by an average of 23 percent or $5.60 per ton. In reality, the 23 percent constitutes the margin of monopoly rent before rail competition existed. If this figure is representative of monopoly rent in other areas lacking rail competition, it provides the railroad and its coal-producing affiliate with a very sizeable margin with which to compete with other producers for coal supply contracts. A five dollar margin in the coal business, especially in the Powder River basin market, would provide an overwhelming competitive advantage not available to non-railroad affiliated producers. In most cases, this margin would far exceed the profit margin available to competing producers. Under those circumstances, non-railroad affiliate producers could not compete and continue to stay in business.

There are many other ways in which a railroad, if it so desired, could discriminate against a competitor in the coal business which is completely dependent on the railroad for transportation services. The discrimination might be overt or more subtle. For example, if a coal company competing with the railroad's minerals affiliate for business needed a spur line to open a new field, would the railroad be anxious to accommodate that need? If the railroad purchased new equipment, would it not be inclined to favor the transport of its own coal, rather than its competitor's? What if there were a temporary shortage of equipment. Who would bear the brunt of that shortage? There are simply too many potential opportunities for discrimination and unfair competition to be protected against by legislation, if a railroad is permitted to enter the coal business itself, either directly or through an affiliate within its exclusive service area.

Most of us here have all spent our careers working with and dependent upon the railroads as the major and often sole link between our product and our markets. That experience does not let us ignore or underestimate the economic power railroads exert upon our business. The concept of having to compete against an entity which also holds monopoly power over our business is one that is unacceptable without adequate safeguards and remedies that are now totally absent.

The industry group that met this summer did discuss our transportation concerns but the remedies offered to avoid the potential of discriminatory ratemaking were all after the fact, after the business had been awarded, and hence of little value to a commercial producer who had already lost the business to a railroad's mining affiliate. The other issue, the possibility for an unfair allocation between a railroad's transportation rates and its affiliate's mine price, was not addressed because really there is no answer. It shouldn't ever happen, but it could, as the past history which led to enactment of Section 2(c) has shown. It is hard to imagine a legislative "solution" that would absolutely protect a commercial producer, if Section 2(c) is repealed. But it is clear that protections afforded in existing laws such as the Staggers Act and the Federal Trade Commission Act (which now exempts common carrier railroads from application of its sanctions against unfair trade practices) would have to be reconsidered and strengthened.

Mr. Chairman, as I said at the outset we are not seeking to shut out additional competition for federal coal leases. Rather, we simply want assurances that the railroads and their affiliate mineral companies cannot exercise their monopoly power within their exclusive service areas over transportation through manipulation of the coal or transportation price components of the delivered cost or through other unfair trade practices. Although Amendment 801 identifies potential areas of abuse: the leasing process, acreage limitations and transportation pricing, the Amendment does little or nothing to safeguard against the potential abuse of that monopoly power -- a safeguard which has been a part of the law for over seventy years.

As Chairman of the ad hoc group that has been discussing these issues with mineral affiliates of the railroads, please permit me to briefly highlight some of our major conceptual problems with Amendment 801.

1. Cooperative Leasing

   The concept of cooperative leasing historically supported by non-railroad mining companies would permit railroads to be coal lessors within their exclusive service areas, and federal lessees in regions outside their exclusive service area. Either of these options could result in the development of both the fee and federal coal in the "checkerboard" areas, yet neither would establish an inherent and unacceptable monopolistic advantage over non-rail affiliated mining companies competing for the same business.

The Department of Interior's proposed regulation published December 30, 1980 (45 Fed. Reg. 85833) is a useful discussion document for further consideration of this issue, so long as the suggested criterion is observed that the private coal owner (the railroad) "...could not participate in the sale as a bidder." This proposal provides a framework for leasing checkerboard railroad owned coal on essentially the same terms and conditions as the adjacent federally owned coal, so that both can be developed as parts of a logical mining unit. The proposal contains suggestions for dividing equitably the bonus and royalties between the federal government and the railroad. The railroad's coal reserves would be treated in the same manner as the federal coal throughout the coal lease sale planning process. This procedure would avoid the gross inequity of permitting a railroad to compete actively in the coal business against another coal company in an area where the railroad holds monopoly power over transportation of coal, but would insure a fair rate of return to the railroad, as lessor, from development of its coal resources. Importantly, it would foster development of those resources.

The basic flaw in the railroad leasing proposal and in Senator McClure's proposed Amendment No. 801 is that it would effectively repeal the Section 2(c) prohibition against railroad acquisition of federal leases even in areas where the railroads hold monopoly power over transportation of competitor's coal, since even if the conditions of Section 2(c)(2)(A) applied, a railroad could acquire federal leases and compete actively against other coal companies completely dependent upon it for transportation services. Further, unless the Secretary makes an affirmative finding that "competition for the federal lease would be substantially enhanced thereby," none of the stated conditions would apply and Section 2(c) would in effect be repealed. Even if the Secretary made such a finding, the railroad could still avoid any condition on its right to bid for federal leases by owning less than a 30% interest in a joint venture that owns the federal lease, or by establishment of a mining unit in which the federal coal reserves constitute less than 35% of the total reserves in the unit. In practice this proposal would effectively gut the protections now afforded by Section 2(c) to captive coal shippers subject to the monopoly power of railroads they must rely on ship coal to their customers.

2. Acreage Limitation

Although appearing to provide additional restrictions on railroad lease holdings, the acreage limitation set forth in Amendment 801 is without real substance. Other than the acreage limitations already in the law, this restriction only limits the acreage of coal deposits that can be leased by a railroad or its mining affiliate adjacent to "land grant" coal deposits, a limit which probably would not be exceeded even without the proposed restriction. On the other hand, as we read the proposed amendment, the railroad or its affiliate would still be free to obtain federal leases adjacent to coal deposits it has acquired through fee exchanges, coal company acquisitions or any other coal leases, without being subject to the special acreage limitation in the railroad proposal.

3. Transportation Contracts

The proposal does not provide the non-railroad coal companies with any new protections and, particularly, any new remedies. Currently, under the Interstate Commerce Act rate discrimination against a coal shipper is not illegal when the traffic is covered by a transportation contract. Thus, the Interstate Commerce Act would not prohibit rate discrimination under contract in favor of a railroad's mining affiliate. As a consequence, it is doubtful whether passage of this legislation would enhance in any meaningful way the ability of an aggrieved shipper to challenge successfully monopolistic pricing practices by the railroad to benefit its affiliuted mining company. Importantly, any remedy which might be useful could only be pursued after the fact, after a contract between the buyer and the railroad mining affiliate has been consummated. The coal agreement and the transportation contract in question would continue in effect and the subject coal would be mined and shipped regardless of whether any challenge may be finally adjudicated favorably to the aggrieved coal company. Further, once mining investments occur and shipments begin, it is difficult to envision a court ordering a suspension of that activity. Under present laws there is probably no effective remedy against the type of unfair competitive practices likely to occur.

Existing remedies require that the problems inherent in this situation be resolved through either the Interstate Commerce Commission or anti-trust litigation. The former historically has provided shippers little satisfaction and the latter presently provides significant exceptions for common carrier shippers, based on the assumption that their activities are adequately regulated by the ICC (which was the case prior to enactment of the Staggers Act). Because of this, we believe that if Section 2(c) is to be amended or repealed, as proposed, a genuine resolution of this issue can only be achieved through revisions of the Staggers Rail Act of 1980 that adequately provide captive shipper protection and prevent discriminatory rate making or product pricing, and appropriate amendments to the Federal Trade Commission and/or other statutes to subject the railroads to adequate anti-trust sanctions.

Repeal of Section 2(c) would raise serious anti-trust concerns, in that it could create an irresistible temptation for the railroads to take unfair advantage of the monopoly position they would enjoy over transportation of a competitor's coal. This issue of unfair competition is addressed specifically by the Federal Trade Commission Act, which prohibits "unfair methods of competition" and "unfair...acts or practices in or affecting commerce" which "are...declared unlawful." The FTC is empowered and directed to "prevent persons...or corporations...from using unfair methods of competition in or affecting commerce." However, common carriers (e.g. railroads) are specifically exempt from these provisions. This Act was passed in 1914, at the same time the predecessor of Section 2(c) was originally passed by the House. The legislative history makes it clear that Congress considered it unnecessary to apply these prohibitions of the FTC Act to railroads, since they were already regulated by the ICC and by provisions such as Section 2(c). See e.g. Congressional debate in the 63d Congress, Second Session, Sept. 8, 1914, 51 Cong. Rec. 14784, 14791-92, in which reference was made to the salutary work of the ICC in regulating the country's railroads and in fixing their rates.

The Staggers Act as now being implemented has in large measure undercut this protection. If Section 2(c) is repealed, the exemption of the railroads from the prohibitions of the Federal Trade Commission Act would certainly have to be reexamined. It would probably also be necessary to include in that Act, or in some other anti-trust statute, private remedies available to a coal company which is the object of unfair trade practices by a railroad which is engaged in the coal business, directly or through an affiliate, and which also has monopoly power over the transportation of a competitor's coal.

The Staggers Act as implemented is already subject to considerable criticism, particularly as it applies to captive shippers. Several bills have been introduced to amend that act. These bills would modify the Staggers Act in an effort to provide adequate protection for shippers dependent upon a railroad to move their products to market. The problems which had led to these legislative proposals to amend the Staggers Act also would be greatly exacerbated by repeal or amendment of Section 2(c). If Section 2(c) is repealed, appropriate protective amendments to the Staggers Act would be required. Some of the possible means to protect captive shippers could be to:

- require a rail carrier which provides transportation services for its coal affiliate and for a competing coal company to do so under public tariffs subject to challenge by affected persons;
- require a railroad intending to provide transportation services for its coal affiliate and for a competing coal company to publish its proposed tariffs in advance and to provide a procedure whereby an affected coal company could challenge these tariffs under guidelines designed to prevent an unfair allocation of profits between the transportation and coal functions of the railroad and its affiliate;
- require a railroad which competes with a coal company to grant greatly expanded competitive access rights to the coal company or another shipper of it's choice.

Each of these possible solutions, and others, would have to be addressed in the light of the potential abuses resulting from repeal of Section 2(c).

Proponents of repeal of Section 2(c) have relied on a 1980 report of the Department of Justice (Competition In the Coal Industry, Nov. 1980) and a 1970 report of the Public Land Law Review Commission (PLLRC). We believe the conclusions of these reports are invalid or inapplicable today, for several reasons. First, as the Department of Justice report itself stated: "...it is not possible to judge the effects of this new legislation (The Staggers Act) at this time." (Department of Justice report, page 71.) The effects of this legislation enacted in 1980 and its implementation by the ICC are now clearer, and as already discussed they are considered pernicious enough in the case of captive coal shippers to require remedial legislation even without changes in the current protections afforded by Section 2(c).[4] Second, the Department of Justice appears recently to have reconsidered the protection afforded by alternate modes of transportation, which previously were considered to afford protection to captive shippers. In opposing the proposed merger of the Santa Fe and Southern Pacific Railroads the Department of Justice recently had this to say:

> "While trucks and other modes compete with railroads for certain traffic, there is overwhelming evidence...that, in the region of the merger, trucks are at a distinct competitive disadvantage for large shipments of rail traffic - particularly bulk commodities moving in large volumes over long distances." (Post hearing brief of the Department of Justice, Oct. 21, 1985, at pages 3-4).

The protection previously thought to be afforded by alternate modes of transportation was a primary reason for the conclusions of the PLLRC in 1970. Third, the Department of Justice 1980 report, which questioned the necessity of a blanket prohibition against coal leasing by railroads in all situations, recognized the competitive problems that "would result...if certain conditions existed, including market power over the transportation of coal." (Report page 88.) This is the area in which the retention of Section 2(c) is required. Finally, the report of the Department of Justice does not really address the issue of "unfair competition" or the prevention of "unfair methods of competition." Perhaps this is because of the exemption the railroads now enjoy from those provisions of the FTC Act. As stated above this exemption would have to be reconsidered if Section 2(c) were repealed.

For basically the same reasons, the recommendation of the Linowes Commission, in which two of the five commissioners recommended repeal of Section 2(c), is in our view also erroneous, to the extent it applies to areas where a railroad holds monopoly power over captive coal shippers. The Report also notes that in the checkerboard areas bidding for federal leases by railroad "may simply displace multiple bidders in favor of the railroad." This is, in our view, quite clearly an anti-competitive result, and is another reason why railroads should not be permitted to bid for federal leases in areas where they have monopoly power over transportation of coal produced by other companies.

Any resolution of the Section 2(c) problem should attempt to achieve two objectives: first, it should encourage the development of U.S. coal reserves including those owned by the railroads; and secondly, it should preclude unfair competition between a railroad and commercial coal companies in areas where the railroad has monopoly over the transportation of its competitors' coal.

Possible solutions which satisfy these objectives might include these elements:

(1) Outside the area of exclusive rail service for shipment of coal to market a railroad would be free to obtain or hold federal coal, just as any other company. This would narrow the scope of Section 2(c).

(2) In an area where a railroad has effective monopoly power over the transportation of coal, it would not be permitted to obtain or hold federal coal, either directly or through an affiliate.

(3) However, within its area of exclusive rail service, if it owns or controls coal deposits adjacent to or within a logical mining unit in which federal coal is to be disposed of by lease or exchange, the railroad or its affiliate could, at its option, offer its coal deposits for leasing with the federal coal. The company acquiring the federal coal would lease the railroad coal on the same terms and conditions. This would insure development of the railroad coal deposits under arms length terms and conditions that would insure a fair rate of return to the railroad.

This conceptual framework has a number of advantages:

(1) It would foster development of coal reserves, including those owned or controlled by the railroads.

(2) It would continue the protections now afforded by Section 2(c) against the potential for unfair competition in an area where a railroad would otherwise be both a competitor and a monopoly supplier of transportation.

(3) It could be accomplished by amendment of Section 2(c), without the necessity of amendments to other statutes such as the Staggers Act and the Federal Trade Commission Act.

The coal industry is certainly prepared to continue its participation in the discussion of this complex subject. It is essential, however, that this dialogue include the railroads themselves, since transportation issues are at the heart of the problem. As the discussion above indicates there may be some ways in which the blanket prohibition of Section 2(c) is too broad. In our view there are other areas in which the reach of Section

2(c) has been construed too narrowly. This is a complicated subject which involves changing laws which have been on the books for over 70 years. Because of the urgency of a solution to problems created by Sections 3 and 7, and the short time in which to resolve these problems, we believe the discussions relating to Section 2(c) should proceed separately from the consideration of needed amendments to Sections 3 and 7.

Let me now turn to Tim Winterer.

Mr. Chairman and Members of the Committee, my name is T. R. Winterer and I am Senior Vice President and Manager of U.S. Mining Operations for Utah International, Inc., a mining company based in San Francisco. Although Utah International is active in mining activities all around the world, we were one of the earliest participants in the development of Federal coal in the Western United States and we retain a substantial interest in the development of our western coal resource.

We would like to concentrate our testimony on the difficulty of bringing a mine into production within 10 years of lease issuance and on the inequity of applying Section 3 to holders of Federal coal leases who have diligently attempted to develop their leases.

In this regard, a short history of our involvement with western coal might be useful. Around the turn of the century our company started as a construction company based in Ogden, Utah. We were involved in such heavy construction projects as the construction of Boulder Dam and the building of the Western Pacific Railroad. As a result of our ability to move large quantities of materials at low cost we were occasionally employed by mining companies to assist them in stripping overburden from mineral deposits and in mining the ore bodies themselves. As a result of this experience, following World War II our company's management decided to seek mineral deposits for our own account and to enter the mining business. At first this was merely an adjunct to our basic construction business but gradually mining became the primary interest of our company and today we are almost exclusively a mining company. We have purchased an oil and gas company and hence are faced with the problem which Mr. Brown will discuss later with respect to the Section 3 proscription on the issuance of new oil and gas leases to a non-producing coal lessee.

Our company was one of the earliest promoters of the development of coal in the western U.S. In the late 1950's we began a search for coal deposits and associated water rights which would permit the construction of mine-mouth power plants to serve a perceived growing western electric power market. We concentrated our interest in three areas — western Colorado, southern Utah and the San Juan Basin of New Mexico — acquiring properties in each of these areas. The San Juan Basin property is a lease on the Navajo Indian Reservation and has developed into one of the largest mines in the western United States, serving the mine-mouth Four Corners Power Plant. Since that reserve is held by virtue of a lease with the Navajo Tribe of Indians it is unaffected by any of the provisions which we are discussing today. However, in each of the other two projects Federal coal leases make up a major portion of the coal reserve.

I would like to give you a summary of our efforts to develop each of these two projects and I think you will agree that they do show diligence on our part.

DANFORTH HILLS

The first project I refer to is in the Danforth Hills area of northwest Colorado. In 1964 our company secured a coal mining lease from the State of Colorado on state lands in the area and the following year obtained two prospecting permits on adjacent Federal lands. As you know, prospecting permits entitled the permittee to a preference right mining lease if he discovered coal in the permit area. Following drilling on one of the permits a Federal coal mining lease was issued to us in 1966. However, due to difficulties with the surface owner on the other prospecting permit we were unable to drill on that area until 1968, when we applied for a preference right lease on the second permit area. That application for lease was denied by the BLM, but in 1970 the U.S. Geological Survey agreed that we were entitled to a lease and so instructed the BLM. Nevertheless, the lease was not issued in time to avoid being caught up in the moratorium on leasing declared in 1971 by Secretary Morton.

We continued to conduct exploratory programs on the lands which we controlled but it was not until 1975 that we were able to obtain a special use permit from the BLM which permitted us to drill on the area of the pending preference right lease application. Finally, in 1977 we resorted to filing suit in Federal court to compel the issuance of the preference right lease, since that area includes an essential part of our coal reserve. By the time of filing the suit we had expended approximately $1,700,000 in developing the property.

In 1978 we continued drilling and initiated environmental studies in preparation for a mine permit application and in 1979 we submitted to Public Service Company of Colorado a proposal to furnish coal from the deposit to one of their power plants, conditioned upon our obtaining the preference right lease. That bid was not accepted.

In 1980 the Federal District Court in Colorado ordered the Interior Department to issue the preference right lease. However, this order was appealed and thereafter our company and the Interior Department conducted negotiations which finally resulted in a settlement of the litigation and the issuance of the lease to us in 1982. Also in 1982 we were able to add to our reserves at the Danforth Hills as the result of being the successful bidder for a tract put up in a competitive sale by the Federal Government.

During all this time we have continued drilling and engineering work and the development of environmental programs for the entire reserve. To date, we have expended approximately $3 million on these properties, not counting the amount paid to the Government as the bid for the issuance of the new lease in 1982. The project includes three Federal leases, one state lease and one private lease and has reserves of over 300 million tons.

Danforth Hills is a deposit that has been developed and engineered to a point where it is participating in the competition for new sales to the electric utility industry and eventually it will be mined as the market develops.

ALTON

The second project to which I would refer is in the Alton coal field of southern Utah. We hold a reserve there consisting of 19 Federal mining leases, 4 state mining leases and 6 mining leases on fee properties, containing in total approximately 250 million tons of reserves in place.

We commenced our acquisition of Federal and state leases in the area in 1963 at approximately the same time that Nevada Electric Investment Company was obtaining properties in the same Alton coal field. During the mid-1960s we conducted drilling and engineering work and acquired water rights for the project. In 1967 we prepared a feasibility study and attempted to market the coal as a fuel supply for the Navajo Generating Station at Page, Arizona. These efforts, unfortunately, were unsuccessful, the Navajo Plant electing to take its fuel supply from Black Mesa on the Navajo Indian Reservation.

In 1969, Utah International and Nevada Electric Investment Company began consideration of the joint development of our holdings in connection with a plant to be sponsored by Nevada Power Company and this eventually led to discussions with various electric utilities interested in the development of the Allen Warner Valley Energy System. In 1974, the Allen Warner Valley Project was announced with Alton Coal designated as the preferred fuel supply.

This led to extensive additional drilling, coal preparation tests, water test wells and the preparation of an environmental assessment. During 1975 and 1976, additional surface rights and coal leases on fee land were acquired and engineering feasibility studies were conducted which indicated the viability of the Alton coal field as the fuel supply for the project. The Secretary of the Interior determined that an environmental impact statement would be required. Mining and reclamation plans were prepared and submitted to the USGS for inclusion in the impact statement.

In 1977 the Los Angeles Department of Water and Power withdrew from the project but in 1978 Southern California Edison Company and Pacific Gas and Electric Company joined the group studying the project. During this period additional work was done in engineering the mine and to develop water for a possible coal slurry pipeline from the mine to the power plant sites.

In 1979, the environmental impact statement was issued and a petition was filed by environmental groups to declare the lands as unsuitable for mining under the provisions of the Surface Mining Control and Reclamation Act which had been passed in 1976.

In 1980 the Secretary of the Interior declared a portion of the coal field unsuitable for mining. Subsequently, in 1981 Utah International and others filed suit challenging the decision of the Secretary on unsuitability. Also, in 1981 Southern California Edison and Pacific Gas and Electric Company withdrew from the Allen Warner Valley Project. However, Nevada Power Company continued with its planning for the project and obtained some approvals with respect to the station site, transmission lines and slurry pipeline.

In 1982 Utah International made application to the State of Utah under SMCRA for a permit to operate the coal mine. During 1983 and 1984 there were continuing delays in the unsuitability litigation and in processing of the mine permit application. However, most of the outstanding claims in the litigation have now been dismissed and it is our feeling that the deposit does constitute a viable mining reserve which will be brought to market as the need for electric power in the southwest continues to grow. To date we have spent in excess of $6 million in work on this property.

Mr. Chairman, both of these deposits are examples of situations where the lessee has made bona fide efforts to develop the leases and where the Government has also played a substantial role in the delay that has been experienced.

Federal coal leases issued prior to 1976 were issued under the statute as it was written in 1920. These leases are for an indefinite term subject to the condition of diligent development and continued operation on the part of the lessee. For over 50 years after the enactment of the 1920 statute, no one ever asserted that diligent development required the production of any particular amount of coal. That idea was first announced by the Department of the Interior in 1975 and was then picked up by the Congress when it amended the Act in 1976. We suggest that diligent development by the lessee under a pre-1976 lease does not necessarily mean production of coal, and the proscription of Section 3 is inequitable. Section 3 penalizes lessees who have made good faith efforts to develop their leases, and are in compliance with the diligence requirements of those leases according to their terms, but who may not have been able to produce coal because the market did not develop, or because of Government action or inaction, or because of the lengthy environmental protection procedures now required in connection with any large project.

We appreciate the opportunity to offer these comments.

Let me now turn to Jack Mahaffey.

Mr. Chairman, I am Jack Mahaffey, President of Shell Mining Company. Shell Mining operates one western mine on a federal lease and has permitted a mine on another lease. In 1982 we were the successful bidder for a third Powder River Basin tract, the Spring Draw lease. My company does not face an immediate Section 3 problem because of our two pre-'76 lease holdings, one is producing and the other, acquired by assignment, has not been held by Shell for 10 years. However, our new lease, Spring Draw, has been tied up in litigation since 1982, three years of the statutory post-1976 10 year Section 7 lease diligent development period. For this reason, I would like to concentrate most of my remarks on Section 7 diligence problems.

The coal industry does not object to the principle of a diligent development requirement. However, I believe that a fundamental misunderstanding has developed over time due to the inappropriate, and often times interchangeable, use of the term "diligent development" as applied to oil and gas development and coal development. The problem in oil and gas is one of finding it, and not so much one of developing and

BEST COPY A LE

marketing. For coal, the problem is reversed. We know where the significant coal reserves are. In fact, before a Federal lease sale is concluded, extensive reserve base analysis is done by both the government and industry. Developing and marketing are the time consuming problems.

Diligent development to assure that government resources are produced on a timely basis makes sense. However, strict requirements for coal lease production by a date certain ignores the very heart of the problem -- finding a market and being able to produce the reserve at a competitive price.

The Federal Coal Leasing Amendments Act (FCLAA) imposed strict development requirements for leases issued after enactment, in large part because of perceived problems with "speculation." Any lease not meeting "diligent development" production requirements at the end of 10 years is terminated by law.

The coal industry feels that it is imperative that the statute be amended to afford more flexibility in meeting this "diligent development" requirement. In today's circumstances, and for the forseeable future, an inflexible mandate to achieve full commercial production 10 years after lease issuance is extremely unrealistic.

A review of marketplace and government action over the last eight years clearly evidences that the development and marketing conditions to which coal producers are subjected have changed. Mr. Chairman, there simply is no way to assure that full production on a lease will be achieved in 10 years. This risk of producing reduces the lease value and hence in the acquisition of federal leases the risk reduces future revenues to Federal and State governments.

The existing law's artificial timetable presumes an ability to make a perfect match of the coal to be produced with the type, quality and amount of coal being demanded by a real buyer, at a particular point in time. When a company bids on a lease it rarely has a customer for that coal. In fact, leases are simply inventories of coal quantity and quality at a location suitable for delivery to potential customers.

Producers need to be able to inventory a sufficient number of leases, which vary as to type and quality of coals, to meet different and often changing buyer requirements. Not all these leases can be put into production immediately. The marketplace will determine which leases will be developed and which will revert back to the lessor.

Mr. Chairman, it generally takes more than 10 years to bring a mine on a federal lease into full production. Testimony presented to this Committee over the last few years has suggested that it often takes anywhere from 12-14 years to develop a large western surface mine.

This effort includes: (1) assembling a mineable coal package; (2) market development; (3) environmental and related studies; (4) design and construction; (5) permit acquisition (6) mining preparation; (7) production build-up; and (8) full production.

Let me note some of the more important time consuming environmental protection steps, which for the most part were passed or fully implemented after passage of the 1976 leasing Act:

- The Surface Mining Control and Reclamation Act of 1977 (SMCRA) requires that all mines on Federal lands must submit a mining and reclamation plan that is approved as part of a permit to mine on those lands. The informational and environmental baseline study requirements for the plans are extensive and can require between three and six years of preparation.
- In addition to the permitting requirements set forth in SMCRA and the implementing regulations, there are extensive environmental performance standards that are applicable to all surface mining operations on Federal lands. Those standards insure that all mining operations are conducted in an environmentally sound manner and address such areas as industrial siting, fish and wildlife, air quality, water quality and postmining land use.
- Because the granting of a permit for a proposed mine on Federal lands is

considered a "Federal action" within the meaning of NEPA, an environmental impact assessment or statement will almost invariably have to be prepared.

- Operators on Federal lands are required to comply with the requirements of the Clean Water Act, which requires NPDES (National Pollutant Discharge Elimination System) permit, the Clean Air Act, the Endangered Species Act, and the various archaeological and historic preservation acts.
- Many states have their own statutes and regulations governing mining operations within their borders and, pursuant to the states' role under cooperative agreements, they are able to impact coal operations.

Mr. Chairman, there are different approaches to providing flexibility to the now inflexible diligent development requirements of Section 7. Our preferred approach is simply to extend the time period, perhaps an additional 5 or even 10 years through payment of advanced royalties, an approach adopted by both S. 570 and S. 372. These bills address this problem by providing flexibility in the application of the diligence standard while maintaining a strong incentive to develop the leasehold. We strongly urge adoption of such a provision.

This subcommittee also has before it S. 946 which would bar the Secretary from issuing a new competitive coal lease to any corporation that produces coal in a foreign country and imports the coal into the United States.

Trade restriction laws damage U.S. relations with other nations and lead to retaliation by other countries against U.S. exports, such as coal and agricultural products.

Reciprocal commerce is essential to the economic health and growth of all nations. An existing section of the Mineral Leasing Act, Section 1, promotes reciprocity among nations and encourages international investment and commerce by prohibiting the Secretary from issuing a federal lease to a foreign person (or a corporation whose stock is owned by a foreign person) whose country does not permit U.S. nationals similar privileges. In contrast, S. 946 proposes to erect a barrier to international trade.

By preventing lease acquisition by companies which are affiliated with foreign coal producers that import coal into the U.S., the proposed legislation would reduce competition for federal leases.

Foreign coal will be purchased by American utilities and other coal customers only if its delivered price is competitive. Increased costs (or foregone opportunities for lower costs) resulting from import restriction will ultimately be borne by the American utility customer or by the consumer of products made by industrial coal users.

Let me turn now to Wayne Ewing.

Mr. Chairman, my name is Wayne Ewing. I am President of Peabody Coal Company, the nation's largest coal producer. On behalf of Peabody, I want to express my appreciation for the leadership of this Subcommittee in dealing with the complex issues of federal coal leasing. We are also grateful for the opportunity to provide testimony in these hearings to determine whether changes should be made in the Federal Coal Leasing Amendments Act (FCLAA) of 1976.

Peabody sees the need for revision of the Federal Coal Leasing Amendments Act in at least six (6) areas:

- Repeal or modification of Section 3, which has been addressed by previous witnesses.
- The definition of affiliate lessees
- The definition of logical mining units (LMU's)
- The ten-year diligence period for post-1976 leases, which Jack Mahaffey covered,
- The requirement for mine plan submittal within three years of lease issuance
- Elimination of the requirement to exhaust an LMU within forty years of issuance

Foremost among the needed changes, chiefly because of its impending August

1986 deadline, is the repeal or modification of the Section 3 prohibition on issuance of new federal mineral leases to holders of undeveloped federal coal leases issued before 1976. A summary of Peabody's extensive efforts to comply with Section 3 will underscore the need for amendment.

In 1976, Peabody held some 31 federal coal leases and 27 Preference Right Lease Applications (PRLAs). Six of these were incorporated into active mining operations at two sites. Today, Peabody has conveyed or has relinquished all but 12 federal leases, all of which are connected with ongoing coal mining operations. Moreover, we have withdrawn some 14 applications for preference right leases, maintaining only those PRLAs which are connected with active mines or for which there is a legal obligation to seek lease issuance. Yet, in spite of these diligent efforts, Peabody will find itself subject to the prohibitions of Section 3 in August of 1986 unless Congress acts. I want to make it clear that our reasons for relinquishing leases and withdrawing PRLA's is not confined to the requirements of Section 3. Rather, it is the result of detailed, long-range strategic planning which showed that the market potential for some of these properties was limited and that the carrying costs could no longer be justified.

Let me briefly explain. By the end of 1985, all of Peabody's pre-1976 federal coal leases will be part of on-going coal mining operations. One lease is currently under production as part of a mine operated by a non-Peabody company in Wyoming. Two Peabody mines have achieved "production in commercial quantities" (i.e., at least 1 percent of the recoverable reserves have been produced) and have thereby met the standard for "diligent development." A third mine involves six (6) federal coal leases and has been producing continuously since 1971, yet because all of the leases are not contiguous they cannot be incorporated into a logical mining unit (LMU) under current law. Hence, some of these leases will not technically meet the diligent development standard by August 1986, and Peabody will therefore be subject to the Section 3 prohibition. I will discuss this problem in more detail later in my testimony. A fourth mine is under construction and will begin coal shipments later this year. Even though it will be producing coal under long-term contract, because it is a very large mine with extensive reserves, it will not have achieved the required minimum production (1 percent of recoverable reserves) by the August 4, 1986 statutory deadline. Hence, Peabody will be subject to the prohibition of Section 3 at this new mine for technical rather than substantive reasons, even though we are diligently developing that federal leasehold. Yet, despite these efforts, despite detailed planning, diligent marketing, construction and, in some cases, relinquishment of leaseholds, Peabody will be barred from obtaining any additional federal mineral leases unless FCLAA is amended.

We therefore urge the Congress to repeal Section 3 as is suggested in S. 570 (Senator Wallop). In the event that outright repeal is not possible, we believe modification of Section 3 should be made in at least three areas:

- elimination of the prohibition against issuance of non-coal federal mineral leases;
- to accept, for purposes of compliance with Section 3, at least a minimum actual production of coal under bona fide contracts, even if production from the lease or leases has not reached the cumulative level required in Section 7; and
- to provide a mechanism for issuance of new coal leases to holders of undeveloped leases through the payment of a non-compliance penalty.

S. 372 (Johnston) would limit the prohibition to coal leases only, and it suggests a penalty payment in the form of either relinquishment of leases containing comparable coal tonnage to the lease or leases being issued or a special rental payment on any new lease issued to a non-complying lessee. We believe the modifications to Section 3 proposed in S. 372 will substantially ameliorate many of the problems, although we continue to believe that repeal of the entire Section 3 would be the most workable solution. We would suggest that a provision be added, however, which will render those leases or LMU's that are in production and under contract to be exempted from any Section 3 sanctions. By any standard of reason, penalties applied to federal coal leases which are in production and under contract are inappropriate.

It is clear from circumstances such as Peabody's that Section 3 of FCLAA is in urgent need of repeal or modification. The apparent broad application of the prohibition against new lease issuance will seriously disrupt the market for federal mineral leases, as companies and their affiliates are forced to either relinquish all undeveloped coal leases or curtail activities involving other so-called "leaseable" minerals because they would be unable to obtain new leases.

If Section 3 continues to penalize lessees who, by any reasonable standard, are developing and operating their leasehold properties in a diligent manner, it is in obvious need of amendment.

Definition of Affiliate Lessee

The prohibition contained in Section 3 of FCLAA[1] applies "to any person, association, corporation or any subsidiary, affiliate or persons controlled by or under common control with such person, association or corporation where any such entity holds a lease..." Nowhere in FCLAA or MLA is there a definition of the term "affiliate." Peabody is wary of the dangers such an omission can present. Regulatory interpretation of that term can potentially place federal coal leasing prohibitions upon corporate entities which Congress may have had no intention to affect. Business relationships exist in which one entity may be technically affiliated with another and yet not possess control over decisions which that second entity may make. Peabody itself is involved in such a relationship. Peabody Holding Company, Inc. (PHCI) is owned in varying degrees by five (5) major U.S. corporations. Two (2) of the shareholding companies of PHCI own slightly more than 30 percent each, two (2) others own approximately 16 percent and the fifth shareholder owns 5 percent. However, not one of those five shareholders actually exercises individual control pf PHCI, and Peabody does not believe that Congress, in enacting FCLAA, intended to extend any prohibition which may become applicable to PHCI to such non-controlling shareholders. While none of the bills before this subcommittee propose a definition for the term "affiliate," Peabody believes that the Subcommittee should consider an amendment which would give an appropriate definition to the term "affiliate" as it might apply in the context of Section 3. The reasonable definition of the term "affiliate" would focus on actual "control" and "the ability to direct policies without the concurrence of other shareholders." Determination of such "control" could then be made on a case-by-case basis without the need, as some may suggest, of a hard and fast percentage ownership rule which undoubtedly would affect unintended affiliates. Peabody urges your consideration of such an amendment.

---

[1] (Section 2(a)(2)(A) of the Mineral Leasing Act of 1920 (MLA)).

Contiguity of Logical Mining Units

Section 5 of the Federal Coal Leasing Amendments Act of 1976 (Section 2(d)(1) of the Mineral Leasing Act) provides for the establishment of logical mining units. This allows for the consolidation of federal, state, and fee coal properties into a single unit or operating mine, "under the effective control of a single operator." It also requires, almost as an afterthought, that all properties contained in an LMU must be contiguous.

As briefly described earlier, Peabody's Seneca mine in Routt County, Colorado, contains six (6) federal coal leases as well as other properties. However, the mine property is divided into three areas separated only by narrow, quarter-mile wide strips of land which Peabody, for a variety of reasons, has been unable to obtain or control. As a result, these three properties cannot be incorporated into a single LMU because they are not technically contiguous. Peabody is currently producing coal in one of the three areas with two walking draglines. In 1986 Peabody plans to move one dragline to a second area in order to begin production and thereby comply with the requirements of Section 3 and Section 7. However, to bring the third area of Seneca into compliance within the time frame required by Section 3 is not possible with present equipment. The surface mineable production is under contract to be delivered to a mine-mouth powerplant and the production requirements at the mine do not presently warrant the operation of a third dragline. Further, the addition of a third machine would substantially and negatively affect the economics of the entire mine. I might add that the properties were obtained and dedicated and the mine was constructed and operating well before the enactment of FCLAA in 1976.

We are certain that other coal companies do, or will in the future, have similar problems with the present contiguity requirement. We strongly support that provision of S. 570 (Wallop) which removes this requirement.

Submission of a Mine Plan

As an additional, unnecessary and punitive diligence requirement, the 1976 Leasing Act required the submission of "an operation and reclamation plan" within three years of the issuance of a new lease. For a variety of reasons this requirement in Section 7(c) is no longer pertinent and should be repealed.

First, this provision was effectively superceded by the enactment of SMCRA in 1977, which mandated the submission of a far more detailed and comprehensive plan prior to the approval of a permit for the operation and reclamation of a mine.

Second, it is inappropriate and untimely to develop a mine plan before you have established a market and determined the level of demand for production from the leasehold or LMU. In many cases, it is not possible to make such determinations within three years of lease issuance. Hence, the submission of the required plan will often be a useless and costly endeavor as subsequent market forces dictate other plans and production levels. Mine plan preparation and submission is keyed to the commencement of construction and production and the time required for permit approval, not to the issuance of a lease.

Both S. 570 and S. 372 propose to repeal the three-year mine plan submittal requirement and Peabody encourages this Subcommittee to support the repeal of that unnecessary and unrealistic provision.

Exhaustion of Lease Reserves

The Federal Coal Leasing Amendments Act of 1976 also requires that all of the reserves of a logical mining unit be mined within a period not to exceed 40 years (Section 2(d)(1) of MLA). Peabody believes this requirement is not warranted.

Under Section 7 of FCLAA a lessee, upon attaining production in commercial quantities, must maintain annual production at a level of one percent of the recoverable reserves of the lease or LMU, computed on a three-year rolling average. This requirement for continued operation is more than ample incentive to work toward exhaustion of the LMU reserves. The 40-year mine-out requirement of Section 2 is therefore extraneous and could create operational and regulatory difficulties. For example, if in the thirtieth year of an operating LMU it become clear that the operator was not going to exhaust the reserves by the end of the fortieth year, and if the mine plan and the physical facilities would not accommodate the required production, the Secretary may be obligated to withdraw approval of the LMU, perhaps cancel the leases involved, or disapprove extension or renewal of a mine plan. This would occur even though the operator was diligently producing coal and was meeting the obligations for "continued operations." Just as the Section 3 prohibition is a harsh redundancy to the Section 7 diligence requirements, so is the 40-year reserve exhaustion requirement redundant and unworkable as an incentive to continue producing from the LMU. S. 570 (Wallop) contains a repeal of this requirement and we urge the Committee's acceptance of that repeal provision.

Conclusion

Mr. Chairman, I want to conclude my statement by reiterating three basic points which we believe are pertinent to this hearing. First, there is obvious need to repeal or modify Section 3. When a lessee, such as Peabody, has made every reasonable effort to be diligent in the development of its leases yet finds itself still penalized by inappropriate or inflexible statutory diligence requirements, then the law needs to be changed.

Second, there are provisions of FCLAA which are no longer appropriate to the realities of the coal leasing program and to the current coal market; they may not have been appropriate even in 1976. The necessity of acting now on the Section 3 issue presents an opportunity to redress those inappropriate and unnecessary provisions, and we urge the Subcommittee to make the needed changes and deletions to the Act this year.

Finally, we believe the Subcommittee should be cognizant of the effect of subsequently-enacted laws, notably SMCRA, which render some of the provisions of FCLAA needless and duplicative. In this context, we believe FCLAA can be amended without any detriment to the environment or the management of the public's resources.

Mr. Chairman, this concludes my statement. Let me turn to Bobby Brown.

Mr. Chairman and Members of the Committee, my name is B.R. Brown. I am Chairman and Chief Executive Officer of Consolidation Coal Company. Consol is a subsidiary of Conoco, one of the DuPont companies.

Consol is the second largest producer of coal in the United States. Last year, we produced 43 million tons of coal from 39 mines in 9 states, including North Dakota, Utah and New Mexico in the west. We are the largest employer of coal miners in the United States, providing jobs for over 11,000 people. We supply coal to the numerous electric utility companies, steel makers, auto makers, and a variety of other industrial companies as well as producing nearly 4 million tons of coal for export overseas. In short, Consol is a major resource development company with the necessary managerial, engineering, marketing and financial capability to develop new mining ventures.

I commend you and your subcommittee, Mr. Chairman, for moving ahead with legislative hearings on the leasing issue. We have been debating many of these issues for five or six years, and it is time to bring the debate to conclusion. I am going to confine my remarks today largely to Section 3 and I would like to give you the coal industry's unified position on the major legislative options before this committee for dealing with the problem.

Bob Quenon and Jack Mahaffey have covered the industry's postion on other important aspects of the federal coal leasing statute before you that need to be amended.

With regard to Section 3, it may be instructive to begin by reviewing Consol's situation with regard to both federal and non-federal reserves.

First, we hold substantial coal reserves nationwide. We report reserves and resources of nearly 12 billion tons. Geographically, those reserves are in virtually every coal region in the country. The reserves are held in fee as well as under lease. Of that reserve base, we hold 31 federal leases issued prior to 1976 which contain an estimated 1.3 billion tons of coal. Our present market outlook suggests that none of these leases will be in production in commercial quantities by August 4, 1986. Because we are also part of a major oil and gas company, the near term need of Conoco to lease onshore oil and gas is likely to drive our decision on what to do with these coal leases. Although we have come to no final decision, it appears likely that the proper business decision for the company overall would be to shed its undeveloped coal reserves in order to continue to lease oil and gas.

Some observers may argue that this is, in fact, what should occur inasmuch as we have held some of these leases for nearly twenty years — demonstrating, at least to them, that we have no interest in developing these leases. However, it may be instructive to review the relationship between reserves and operations in one of our major production areas. As the Chairman is well aware, Consol is a coal producer in your home state of Virginia. We continue to invest in new mine capacity, not only in Virginia, but in Pennsylvania and West Virginia as well. Nevertheless, we also hold uncommitted coal reserves which we have held for fifty or sixty years. Even though we have held these reserves undeveloped for many decades, it would be incorrect to conclude that Consol has no interest in developing its coal holdings.

This illustrates a fundamental aspect of the coal business. Not every reserve can or even should be developed in a short period of time after it is acquired. The speed with which a reserve is developed depends on how well it matches with market demand and should not be construed as a measure of our interest in developing it nor in the ultimate value of the reserve itself. We believe that virtually every reserve will have value to us in time. A reserve that cannot be developed now because of a lack of adequate transportation, for example, may become our best operation 50 years from now when the transportation situation changes. The point is that we look at reserves in terms of their long term strategic value to the company. We cannot predict what the market will be ten or twenty years from now, but we take every step we can to assure that our company has an adequate inventory of uncommitted reserves to match the demands of the customer of the future. That requires us to acquire and hold a variety of coal reserves in a variety of locations. Because we have done that in the past, we have grown as a company, provided work for thousands of people and met market demands through the country.

If we are forced, because of the requirements of the oil and gas segments of the company, to shed our pre-1976 federal coal reserves, we lose more than their strategic value. Just as in Tim Winterer's case, we have invested more than $8 million in these leases in direct cash costs for exploration and environmental work. In addition, we have invested countless man-hours in the difficult task of defining the nature of the reserve under lease and examining the various ways in which the reserve could be mined. In a sense, this intangible investment would become the greatest loss not only to Consol but to the country at large if all our reserves are relinquished. The more we know about the reserve in the ground and the more time we spend refining our engineering, the better we are able to match the reserve to the right customer and the more likely it is that the mine will be an economic success. From the time the lease is acquired, we begin to develop the best geological, engineering and environmental data we can about the reserve. This work helps our marketers do a better job of matching customer requirements with reserves we hold. Of course, all this doesn't guarantee a sale, but it is a tremendous expenditure of human resources which will be wasted if we are compelled to relinquish these reserves because they have not been developed in time to meet an arbitrary deadline.

I am here today to urge you to change Section 3 in particular. It is frequently argued that the coal industry ought to pay a penalty of some sort in return for amendments to Section 3. This implies some failure on our part to carry out our obligations -- legal or otherwise. I believe that we acquired those leases in good faith and have diligently developed them within the context of the coal business as it really is. Whether or not a coal reserve is in production in an arbitrary number of years is not necessarily the only measure of diligence by which we should be judged. The dilemma we find ourselves in today is created by changing views of what our obligations ought to be. We are being judged by rules which weren't in existence when we began the game, and being penalized for behavior which yesterday was deemed normal and appropriate. Moreover, these rules presume an attitude of speculation on the part of industry which simply does not exist.

I believe, as I have for some time, that Section 3 ought to be repealed. Whatever Congress believed its virtues to be in 1976, those virtues surely do not exist today. S. 570, introduced by Senator Wallop, provides for repeal and is before the committee. The coal industry strongly supports this option on the grounds that it is the most efficient, equitable, and straightforward way to deal with the problem. However, I am aware of the controversial nature of this issue, and you are aware that the coal industry, including Consol, has already expressed a willingness to accept a compromise on this issue. Therefore, let me direct my remarks to S. 372 because I think that Senator

Johnston's bill provides a useful framework for a compromise. First, S. 372 limits the effect of Section 3 to coal. We support that change. If Congress chooses to evaluate our performance on federal coal leases, then any penalties should be related only to coal leases. Second, the Section 3 prohibition would be triggered only when a company attempts to acquire a new coal lease at a competitive lease sale. This overcomes several dilemmas. It means that the Department of the Interior would not be precluded from issuing preference right leases to applicants with undeveloped pre-1976 leases. This seems fair inasmuch as many PRLAs have been pending since before the 1976 Act was passed. Further, it would not preclude the Department from issuing leases pursuant to congressionally mandated exchanges. We are currently completing negotiations with the Department on such an exchange and would be helped by this provision of the Johnston bill.

Third, the Johnston bill provides two methods for a holder of non-producing pre-1976 leases to qualify for future lease sales. These are ad hoc compliance measures, in effect, because each time you are the winning bidder at a lease sale, you must elect to do one of these two things if you still hold undeveloped pre-1976 leases rather than qualifying once for all future lease sales.

The first method of qualifying is to relinquish or "turn back" to the government, from your pre-1976 leases, a number of tons of coal equal to the number of tons you receive in the new lease. I think the turnback concept is a useful compromise although I believe that it would be simpler to establish the turnback on some sort of acre for acre basis. Nevertheless, I think the turnback idea is desirable for a number of reasons.

First, it allows a company to continue to compete for new leases without actually increasing the number of federal tons it has under lease. As you are aware, the Department of the Interior frequently is criticized at each lease sale for leasing coal when 16 billion tons of coal already exist under lease. To the extent that the turnback concept is utilized, that argument is mooted because new coal is leased but "old" coal is returned to the federal domain. Further, the government benefits because the development potential of a company's lease holdings improves, which will ultimately lead to production and the payment of production royalties to the government, and the number of competitors at future lease sales is not restricted, improving the chances for vigorous bidding at each lease sale.

Second, the "turnback" concept begins an orderly process of returning to the federal domain old leases which were not subjected to the land use planning and screening processes to which leases offered today are subjected. Although current environmental statutes guarantee that every lease will be developed in an environmentally sound manner, the relinquishment concept may encourage companies to view those leases with the greatest environmental problems as the most likely candidates for relinquishment.

Finally, the turnback concept provides a far more orderly disposition of old undeveloped leases than would otherwise occur if Congress does not amend the current Section 3 provisions. Companies would benefit because we would avoid writing off our books, virtually overnight, a substantial asset base. The Department of the Interior would benefit because lease relinquishments would occur at a far more manageable pace, easing processing demands on the Department. And finally, the taxpayer would gain because revenue losses due to tax writeoffs of the relinquished assets would be minimized.

Let me add as a final footnote to the turnback concept that this approach is not an exchange. It is a transaction in which the government receives fair market value for the new lease it offers and imposes, in addition, a penalty on the lessee if that lessee still holds undeveloped pre-1976 leases. The penalty, of course, is the relinquishment of leases by the lessee earlier than the lease terms would otherwise require. In an exchange, conversely, the government merely trades leases with the lessee without receiving any additional bonus bid or without imposing any penalty on the lessee.

Because the "turn-back" is not an exchange, it is not necessary for the Department to go through the elaborate evaluation process it uses when it is exchanging one lease for another.

The other option provided for in the Johnston bill for qualifying for new leases is to pay an additional annual rental on the coal being acquired. The concept is similar to that of turnback in that the government receives fair market value for the lease it offers and then imposes, in addition, a penalty, in the form of additional rentals, as the price the lessee must pay for continuing to hold undeveloped pre-1976 leases. We support this option. There is a provision in S. 372 as currently drafted, however, which would severely limit the utility of this option for many companies. As drafted, the holding fee option is not available to lessees who hold more than two non-complying leases. Many companies have projects that typically involve more than one federal lease in an LMU and would hence be barred from participating in future lease sales unless they give up well engineered properties. The beauty of Senator Johnston's approach is that it provides flexibility to meet Section 3 requirements that can be tailored to each company's individual situation. This restriction removes that flexibility for no apparent public policy purpose and we accordingly would strongly recommend that it be deleted.

In our judgment, S. 372, with one modification provides additional flexibility for the resource developer while, at the same time, continuing to provide pressure to develop leases, which is the ultimate goal of the coal leasing policy. I urge the committee to adopt these two approaches in place of the current provisions of Section 3 in FCLAA.

I also want to reiterate Jack Mahaffey's remarks on the sections of S. 570 and S. 372 which provide for the payment of an advance royalty in order to extend a lease beyond the tenth year. This provision would affect all new leases and those issued since August 4, 1976.

The payment of advance royalties in lieu of production is a well established practice in the coal industry with regard to privately-owned leases. These payments are made to provide the owner of the coal with a guaranteed income stream prior to commencement of actual production. Typically, these advance royalty payments are fully recoupable against the production royalty. However, the advance royalty is not used as an incentive to development of the reserve nor is it a penalty for failing to develop the reserve. It is merely a method of providing income to the coal owner.

In addition, these bills provide for the full recoupability of advance royalties against the prodction royalty. This is consistent with existing practice on privately held leases.

Finally, let me congratulate the entire subcommittee for its willingness to tackle this difficult issue. For too long, the controversy surrounding the leasing program has discouraged Congress from acting to correct the many problems inherent in the Act. I hope now, under your leadership, Mr. Chairman, we can finally begin to make some progress on this important task. I thank the committee for its generous invitation to appear today. We will be glad to answer questions.

The **Chairman**. Thank you, gentlemen, very much. There may be some questions to be submitted for the record for response in writing. I have no questions that I will ask at this time in the interest of time and the other witnesses that yet have to be heard.

I appreciate the time that you have taken in preparing the position of the coal industry and presenting it here as an industry position. I think that will help us as we go forward, and I recognize that has required some give and take among each of you to come to that common position.

Thank you for your testimony.

Mr. **Holsten**. We appreciate it.

The **Chairman**. We'll next hear from a panel composed of Mr. John McCormick, the Environmental Policy Institute; Mr. Brooks Yeager of the Sierra Club; Mr. Dave Masselli, Western Organization of Resource Councils.

I understand that Mr. Geoff Webb, president of Friends of the Earth is unable to be with us today, but will file a statement for the record.

Gentlemen, you have, I'm certain, heard that we're limited in time and ask you to summarize your statement. You're all experienced witnesses, some might say professional witnesses. Certainly you're not unfamiliar with the necessity of the committee to conserve our time as much as possible. We have read your statement. I would invite you to summarize the high points. Your statement, of course, will appear in full in the record.

Mr. McCormick.

STATEMENT OF JOHN L. McCORMICK, ENVIRONMENTAL POLICY INSTITUTE

Mr. **McCormick**. Thank you, Mr. Chairman. Mr. Chairman, I am John McCormick. I am a Washington representative with the Environmental Policy Institute. Our organization has been involved in the national coal policy debate since 1972, and through those years we've always advocated the use of our domestic coal and we've worked with the Congress to set guidelines on the mining, the transportation, and the utilization of that coal.

In that regard, Mr. Chairman, our organization worked in 1975 on the Federal Coal Leasing Act amendments, and as a part of that debate we encouraged the diligent development provision of that law, and we hope that this Congress doesn't weaken that provision at all.

Secondly, Mr. Chairman, our organization opposed the repeal of section 2(c). It wasn't a philosophical opposition, Mr. Chairman. We're opposed for several reasons. I'd like to list several of those.

We believe, then, Mr. Chairman, that because the railroad affiliate coal companies have data on the quantity and the quality of the coal they have adjacent to potential Federal coal acreage, that they'd have an advantage in the bidding process.

Second, they could drive away prospective bidders, Mr. Chairman, by refusing to negotiate access to their coal lands in the event they didn't win the bid. And third, Mr. Chairman, because they have parent railroad companies, their affiliate coal company could get special preferential treatment on rail rates and, therefore, discriminate against other coal producers.

And finally, Mr. Chairman, they could subsidize a part of the bid they offer to the Federal Government because they wouldn't be paying royalty on the other half of the logical mining unit, the land that they own.

Mr. Chairman, we thought we were going to come prepared with our 1975 statement, just changing the date on it. But, fortunately, Mr. Chairman, you offered a proposal which, I think, is worthy of consideration. It's not perfect in and of itself, but, I think, it's an honest attempt to answer the four complaints that we've raised. And I won't go into detail on your proposal, Mr. Chairman, except to say that I hope that my colleagues at this table will at least give me some latitude to say that this is a point from which we could begin to discuss section 2(c).

I know that they are going to be discussing sections 3 and 7 with you, Mr. Chairman, and I'll defer my views on that issue to them. Although, Mr. Chairman, there is one point I'd like to raise about your proposal and that is that it appears the protection mechanisms that you provide in your bill are really only triggered if the railroad company decides to become an active bidder. If it chooses not to offer a bid on a checkerboarded acreage that adjoins their land, then the Federal Government may in a sense be locked out of offering that land for bid.

I don't come here, Mr. Chairman, with a remedy for that situation, but I raise it as something that will have to be addressed.

And finally, Mr. Chairman, given the conversation this morning about sections 3 and 7 becoming magnets for other pieces of legislation, we heard the Staggers Rail Act, the Coal Slurry Pipeline legislation, the Fuel Use Act, I'd like to add another, and that would be the Public Lands Acid Rain Mitigation Act.

And with that, Mr. Chairman, I'll end my testimony.

[The prepared statement of Mr. McCormick follows:]

ENVIRONMENTAL POLICY INSTITUTE

TESTIMONY OF JOHN L. McCORMICK

BEFORE THE SENATE ENERGY AND NATURAL RESOURCES SUBCOMMITTEE

ON ENERGY AND MINERAL RESOURCES

ON S. 570; A BILL TO AMEND THE MINERAL LANDS LEASING ACT OF 1920

NOVEMBER 8, 1985

* *

MR. CHAIRMAN, AND MEMBERS OF THE SUBCOMMITTEE;

It is a pleasure to appear before you this morning to present the views of the Environmental Policy Institute on this important matter. The Institute has been a participant in the national legislative and policy debates regarding U.S. coal production since the organization was established in 1972. We continue to support the responsible development of coal as a necessary part of the nation's energy policy. However, that support is predicated upon the federal government's willingness to enforce those laws which govern the activities of coal producers as they pertain to coal mining and the orderly development of federal coal reserves.

Among the laws governing the private sector development of public resources is the Mineral Lands Leasing Act of 1920. That law was extensively amended in 1975 by the Federal Coal Leasing Amendments Act of 1976. .During that debate, the issue of the repeal of section 2(c) was argued vigorously and that amendment was rejected by the House Interior and Insular Affairs Committee. However, legislation repealing 2(c) passed the Senate in 1957, 1962 and 1966. The Institute opposed its repeal in 1975 and continues to hold strong reservations with regard to its repeal today.

The history of section 2(c) has been mired in interdepartmental battles in recent years as the interest in Western coal development increased since the mid-1960's. Since the 1920 law was enacted, the Department of the Interior (DOI) has taken the position in the Sheridan-Wyoming Coal Company issue, in 1945, that section 2(c) does prohibit leasing to a company which controls or is controlled by a railroad. Later, DOI ruled that the section does not prohibit the leasing of federal coal lands to railroad affiliates when it decided the Colowyo Coal Company issue in 1979. The Justice Department has continued to hold that railroads, affiliates and holding companies of railroads are prohibited from leasing federal coal pursuant to section 2(c).

DOI opinions of the Solicitor's Office on May 18, 1978 and January 4, 1979, made distinctions between section 2(c) and section 27 of the Mineral Lands Leasing Act to justify permitting the leasing of federal coal by railroad holding companies. In section 2(c), DOI saw a special treatment of railroads wherein that section specified; "...no company or corporation operating a common carrier railroad shall be given or hold a permit or lease under the provisions of this Act for any coal deposits except for its own use for railroad purposes:". Whereas, section 27 limits the number of leases a lessee may hold and defines corporate ownership in greater detail. DOI saw that distinction as authorizing all but companies operating a railroad directly or through a corporate structure that could be characterized as the "alter ego" of the lessee company to lease federal coal.

Regardless of the DOI and Justice opinions, the legislative history on 2(c) is clear in one respect. The Congress sought to separate coal mining operations from railroad operations. In a floor statement during the debate on S. 2812, in the 65th Congress, the Committee Chairman, Senator Ferris noted:

> "No railroad shall be a producer of coal except for its own use. It is thought that such separation of transportation from production will go a long way toward stamping out rebates, oppressive methods in shipment, and other existing evils.".

Proponents of the repeal of 2(c) claim that the fears of the earlier Congresses no longer apply and, given the enactment and enforcement of anti-trust laws, the dangers of railroads having competitive advantages if permitted to lease federal coal are unfounded. However, those views are easily challenged and offer no confidence that repeal of 2(c) will not invite the same potential abuses opponents have been citing for years. In fact, recent activities among the three principle Western railroads, the Union Pacific (UP), the Burlington-Northern (BN) and the Santa Fe (SF) indicate their eagerness to expand development of Western subbituminous coal for domestic use and foreign export. This Committee should not create new potential abuses of existing laws which could greatly frustrate competition in the Western coal industry.

The U.P., BN, and the Santa Fe railroad have between them, control of more than 16 billion tons of proven recoverable coal reserves in the Northern Great Plains and the Southwestern coal fields. Of those reserves, approximately 15 billion tons, or 93%, is in a checkerboard pattern of ownership. About 9 billion tons of railroad coal is uncommitted. That amounts to 17% of the total uncommitted non-federal coal reserves in the West. Most of that uncommitted coal (95%) is in those checkerboard land patterns.

Most of the coal reserves under control of the three railroads were acquired from the federal government as granted lands between 1850 and 1871, during which time 160 million acres of public lands were transferred. The primary purpose for the conveyance of the lands was to provide the railroads with a basis for financing construction of their lines by enabling them to raise funds from the direct sale or to obtain credit on the lands held. As of December 31, 1941, total net proceeds received by the railroads from land grant property was $435 million. The remaining lands, totaling about 16 million acres was valued at $60 million at that time. With the transfer of almost 10% of the continental land surface to the accounts of the railroads, they were able to finance about 17,500 miles of trackage, or about 7% of the nation's total.

While the remaining grant lands have a significant resale value, the economic value of the surface resources and underground minerals is immense. Timber, oil and natural gas, hardrock minerals abound on these Western lands. Much of those resources are being developed actively by the railroads. But, without a doubt, the greatest land grant assets possessed by those three railroads are the recoverable coal deposits. With present market prices of $10 to $12 per ton of strip mined coal in Montana and Wyoming coal fields, the gross value of the railroads' 16 billion tons of coal deposits is somewhere between $160 and $192 billion. For the railroads, however, that potential revenue will be difficult - in some instances, impossible - to generate since so much of that coal is tied up in the checkerboard ownership pattern. Therein, rests the issue of 2(c).

When the federal government granted lands to the railroads more than a century ago, it was not aware of the extent of the massive coal deposits beneath the surface. The value of the land was represented in the timber, the rights-of-way and the resale value of the surface to prospective settlers. The companies were awarded alternate section of land (one square mile) on either side of the right of way, often 10 to 20 sections wide for each mile of track constructed. This land pattern created great swaths of railroad land across North Dakota, Montana, Wyoming and parts of the Southwest. They ranged from 20 to 120 miles in width.

Where contiguous acreage was not available, the railroads were able to select land not adjacent to their rights-of-way. The companies were free to make use of the timber and coal resources they had acquired, with the stipulation they be used for the explicit benefit of the railroad operation. That condition continues to receive the broadest interpretation as the original railroad companies found themselves being acquired by holding companies with ambitious plans for the development of those resources for profit.

Prior to the mid-1960's, there was little or no interest in marketing Western subbituminous coal. It was too far from the market and too low in heat value to transport over a long distance. It could not compete with the high quality Appalachian and Midwest coals supplying a rapidly growing electric utility market in the eastern half of the nation. However, population growth in the West and Southwest after World War II; the Mid-East oil embargo and formation of O.P.E.C.; and, tougher Clean Air Act standards combined to give Western coal a resounding boost in the coal market. From a regional production total of less than 20 million tons in 1965, Western coal mines now produce almost half of the nation's mined coal. Consequently, the pressure upon the Federal government to open unleased Western coal lands during the 1970's was enormous. The Western railroads were, and continue to be, vocal advocates for expanding federal coal leasing.

Checkerboarded coal ownership patterns present a difficult resource development and management problem for both the railroads and the federal government. Neither party can achieve maximum economic benefit from their development without cooperation. Assume the red squares of the checkerboard are owned by a railroad and the black squares are held in the public trust by DOI. If the Department offers its coal for lease to other than the adjacent railroad, a bidder would have had to previously negotiated with the railroad for future access to the contiguous sections of coal surrounding the leasable sections. Without such access, the non-railroad bidder would risk his capital and market position since a buyer would not be interested in contracting with a coal producer that does not have a logical mining unit sufficiently large to provide a long-term supply.

Therefore, the call for bids on the federal section would find either ridiculously low bids from prospective lessees anticipating difficult and expensive negotiations with the adjacent railroad; possible collusion between the adjacent railroad and a prospective bidder; or, no bids at all. Those prospects do not generate competition and certainly frustrate the purposes of the federal coal leasing program which should be designed to assure maximum financial return for the public from the sale of its resources.

If, however, section 2(c) were repealed, the adjacent railroad could secure a huge mining unit at a very low cost by discouraging potential bidders unable to negotiate with the company for access to the adjoining blocks of coal. The railroads would have the best information on the quality, quantity and mining conditions of the federal sections it surrounds and DOI has put up for bid. Where the railroad is the sole bidder, the public would lose considerable revenues since there would be no competition. The bid would go for a bargain basement price and the railroad could double its coal holdings for a fraction of the true cost of the additional coal. In that sense, repeal of 2(c) would constitute a second federal land grants program.

Another argument against the repeal of 2(c) is the prospect that, once the federal section is leased to a railroad, the company would then develop the mine and transport the coal. Western coal is mined from thick seams often 40 to 80 feet thick and close to the surface. Massive earth-moving equipment cuts down on labor costs, increases productivity and reduces the production costs. However, its shipment is very expensive, given its low quality and distance from the Midwest markets. If the railroad is hauling its own coal, though, it could subsidize a part of that transportation cost and offer a buyer an artificially low price and drive out the competition from the Western coal fields.

In the early days of the debate on prohibiting railroads from leasing federal coal, many held the view that the Commodities Clause of the Constitution would prevent railroads from thwarting competition by hauling their coal at preferrential rates. Enacted in 1906, as an amendment to the Hepburn Act, the

Commodities Clause was intended to prohibit railroads from transporting goods which they produced or owned. However, recent Supreme Court decisions have opened the interpretation and application of the Commodities Clause and railroads have found legal means to get around the restrictions. Goods owned or produced by railroad affiliates have been found to be legitimate goods which can be shipped by the railroad without violating the Commodities Clause. This interpretation, when tied to repeal of section 2(c), could open the door to all types of competition and consumer protection abuses.

Repeal advocates dismiss those charges by citing the diverse makeup and huge production capacity of the Western coal industry as proof that new entrants, such as railroads, will not have the market power to capture and dominate the coal market. However, the Western coal market is not growing as it was in the 1970's. The drop in oil prices and energy conservation have had numbing impacts upon price and demand of Western coal over the past four years. Under these conditions, railroads could very likely take advantage of the non-railroad competition and take over large shares of both the domestic and export trade if they have the opportunity to greatly expand the coal holdings, mining operations and delivery systems. Since federally owned checkerboarded coal deposits are generally situated along railroad rights-of-way, it would be more attractive to buyers since shipping costs would be diminished.

The anti-trust laws should, theoretically, curb any abuses of anti-competition or monopolistic practices but the Assistant Attorney General for the Justice Department testified in 1981, before the House Judiciary Committee, that Justice is reviewing its priorities in the area of antitrust enforcement. He gave the distinct impression that the Department would not be placing a high priority on the vigorous pursuit of antitrust violations. Given the enormous and complex series of corporate mergers and acquisitions in the past four years and a general reduction in federal scrutiny in these business transactions, it is unlikely the Department will crack down on abuses of the Commodity Clause by railroads.

Mr. Chairman, the issue of either retaining section 2(c) or repealing it comes down to several basic, though controversial, points. They are as follows:

1) railroad affiliate coal companies have sufficient data on the quality and quantity of the interspersed federal coal sections to give them an unfair edge over their competitors in the bidding process;
2) they can drive away prospective bidders by refusing to negotiate with competitors for access to adjacent railroad-owned coal lands:
3) they can subsidize a portion of a bid offer by factoring in the economic benefits derived from not having to pay a royalty on their adjacent coal holdings;
4) railroad affiliated coal companies can receive preferrential rates from the parent railroad for services associated with the transport of coal mined by the affiliate coal producer.

Proponents for retaining section 2(c) have argued these points for years while proponents for repeal have countered those views for an equal number of years. The impass has been without end because there was never a serious counter measure offered to the debate until Senator McClure entered his Amendment No. 801 to the debate. Finally, both sides of this long-running standoff have something to consider aside from tallying votes for and against repeal.

The McClure amendment is, in the opinion of the Environmental Policy Institute, a creative and genuine attempt to meet the objections of the repeal opponents with sensible provisions that open the federal leasing process to railroads while fostering competition among the bidders. On both counts, the McClure amendment protects the interests of the American public as owners of the federal coal and as consumers.

The McClure amendment addresses the four complaints we have regarding repeal of 2(c) in the following ways.

(a) Data disclosure:
  - when a railroad-affiliated coal company

The McClure amendment addresses the four complaints we have regarding the repeal of 2(c) in the following ways:

(a) Data Disclosure -

- if a railroad affiliated coal company wants to bid on a federal coal lease in a checkerboarded area where its coal abuts the federal coal and the Secretary finds that competition would be enhanced by regulations, the company must make all of its exploration data on the coal it owns available to other potential bidders at a reasonable cost;

(b) Discourage Other Bidders -

- if the railroad affiliate coal company enters a bidding process and fails to win the lease, it must automatically lease its coal to the winning bidder. The terms of the railroad's lease agreement must be approved and announced by the Secretary prior to the lease sale;

(c) Preferrential Rail Rates -

- if a railroad affiliated coal company ships its coal from a federal lease-hold area, it and the railroad must submit to the Secretary the coal supply contract; the transportation contract; and all bids submitted by the railroad to the coal purchaser for hauling other producers' coal.

  A competitor, having made a timely bid to supply coal to the purchaser and who has no alternative for shipping its coal may petition the Secretary to disclose the two contracts and transportation bids. If the producer is not satisfied that the railroad's negotiation with the purchaser was reasonable and just, the producer may use the disclosures to seek judicial relief by filing a prosecution against the railroad.

(d) Padded Bidding -

- if a railroad affiliated coal company offers a bid on adjacent federal coal, it can over-bid for the federal coal since it can factor the economic benefits derived from its non-federal royalty coal. That would discourage cometition in the bidding process but two provisions in the McClure amendment work against that becoming a widespread abuse.

The acreage limitation restricts a railroad affiliated coal company to holding a total of 23,040 acres of federal coal lease lands. This national total is one-half the acreage limitation that any non-railroad lease holder may acquire in any one State. That is hardly an incentive for railroad management to shave profits just to secure a lease of federal coal. And, the company must still comply with the data disclosure and cooperative leasing provisions of the amendment.

While the amendment goes a long way towards answering our longstanding complaint with 2(c) repeal legislation, it only improves the federal coal leasing process, in those cases where railroad coal adjoins the federal coal and the railroad affiliate coal company decides to offer a bid. If the company ignores the call for bids on the adjoining federal tract, that might discourage any bids because the adjoining railroad would not be required to negotiate a cooperative lease agreement. The potential winning bidder would not have access to the railroad coal if it could not negotiate lease terms on its own and the federal coal lease sale would likely have to be withdrawn. In other words, the adjoining railroad would have the power, as it does today, to control the ulitmate use of the public's resources which the railroad surrounds in the checkerboarded areas.

If there is an equitable solution to this potential railroad lock-out of federal coal deposits from the leasing process, this amendment does not provide it and we do not have a remedy at this time either. Those opposing the repeal of 2(c) or its modification have not provided a solution to this situation and it is likely that it can remain unchanged.

Mr. Chairman, again, we want to commend Senator McClure for offering the first reasonable compromise to the railroad coal leasing debate. If this Committee chooses to accept it as an alternative to straight repeal of 2(c) that would be a welcome improvement in the debate. However, if it also included a coal slurry pipeline eminent domain title to the bill, that would cause us to oppose final passage of that coal leasing amendments report.

The CHAIRMAN. Thank you very much.
Mr. Yeager.

STATEMENT OF BROOKS B. YEAGER, WASHINGTON REPRESENTATIVE, THE SIERRA CLUB

Mr. YEAGER. Thank you, Mr. Chairman. I appreciate the opportunity to testify before you today on the question of section 3, section 7, and to some extent section 2(c). I'll concentrate my remarks primarily on the bills before the committee which deal with the issue of section 3 and the so-called old coal leases.

As you know, the Sierra Club has long had a deep and abiding interest in the management of America's public lands, and it's from that perspective as well as from our interest in a rational energy policy for the United States that we approach the section 3 problem.

We believe that the two comprehensive bills pending before the subcommittee, Senator Wallop's bill and Senator Johnston's bill, would make broad-ranging modifications in the provisions of Federal coal law which govern the so-called diligence requirements.

These modifications would affect not only the operative diligence requirements for leases issued after 1976, but also the statutory development requirements for older leases. We believe the enactment of either of these bills would represent a significant and unwise retreat from what was a deliberate and considered congressional position on diligence which was established by the enactment of the Federal Coal Leasing Amendments Act of 1976.

I want to make it clear that we don't advocate the forced relinquishment of operating leases as a result of so-called technical violations of the law and in that position, I think, that we agree with some of the comments made by the representative from the Peabody Corp., Peabody Holding Co.

But it seems to us that there are really two problems that have been discussed in regard to section 3 today. There's the kind of problem that is dealt with or is represented by the gentleman from Peabody, or similar problems have been brought to the committee's attention, I think, by statements by Mobil Oil Corp. and perhaps Arco that have to do with the difficulties of interpretation of the law for operating mines.

We don't believe that those problems warrant the kind of broad-based legislative attack on diligence that is represented in these two bills. And, in fact, we are of the belief that those problems can be dealt with administratively under the guidelines recently finalized by the Department.

Instead of dealing specifically with those kind of peripheral problems, the two comprehensive bills pending before the committee would essentially repeal, or repeal with some modifications, the section 3 development requirements of the law.

We think that in doing so, they would reward the worst violators of Congress' diligence requirements. They would reward the violators who hold the largest reserves and we've in fact adopted a deliberate strategy of acquiring large, billion-ton reserves of public coal and then sitting on them to see if the market would improve.

That's exactly the strategy that Congress declared to be out of the range of fair play under the public coal reserves of 1976. We believe the Congress was right at that time, and we think the enforcement of that section of law will not be a terrible thing, to quote Senator Johnston, but in fact will be a beneficial thing, and we'd like to talk about why for a second.

Chairman Udall of the House Interior Committee, in speaking to the American Mining Congress earlier this year, said very briefly, I think, what we believe the intent of those sections of law were. He said section 3 and section 7 were viewed as mechanisms to force diligence, to avoid speculation, to require production, to avoid the abuses of the past where leases were held almost indefinitely without any production or intent to produce.

Now, more recently, there have been two myths developed about those provisions of law. The two myths go approximately like this: Congress didn't know what it was doing in 1976, and there's a variation of that myth that says that after all, all this was written by Patsy Mink and she was from Hawaii, so what does she know about coal leasing. And then, second, that the enforcement of section 3 will cause chaos in the mineral-leasing markets.

We believe both those myths are false. Our statement deals with the legislative history of the act and I think it attempts to show that both this committee and the Interior Committee didn't know what they were doing in 1976.

But to deal with the second myth, that is, the myth of market chaos, we'd like to say that in our belief, the forced relinquishment of many of these old coal leases would be a benefit both to the markets and to the environment. Prior to the passage of the Federal Coal Leasing Amendments Act, there wasn't any statutory requirement that the Government receive fair market value for leasing public coal.

As a result, many of the pre-1976 leases were issued with extremely low royalty rates and often without any competitive or bonus bidding whatsoever. Because they were issued prior to the advent of FCLAA and the Surface Mining Act, they were also issued without any real rational land-use planning.

The result is that many of these leases, even if they are brought into production, will not produce significant revenue for the Federal Government and, second, that many of these leases, were they to be brought into production, would pose unacceptable environmental conflicts.

The enforcement of section 3 would allow the Government to correct these mistakes. It would allow the Government to recoup millions of dollars in lost revenue through the resale of those leases which may have commercial value, and it would allow the Government to avert the environmental damage which may result from the strip mining of environmentally sensitive tracts by declining to release those tracts.

As a last point concerning the market chaos, I'd merely like to say that this is the third time I've heard representatives of the Department of Interior come to a congressional committee and say that enforcing section 3 will cause chaos in the oil- and gas-leasing program. Mr. Chairman, as you know better than most people, the oil- and gas-leasing program is already in such chaos that everybody in Congress is having headaches figuring out what to do about it, so it's a little ironic for them to tell us that that program will be thrown into chaos by enforcing this other article of law.

I have a number of comments about the specific bills, but I will withhold them and hope that they will be entertained by the committee and the committee staff in reviewing the legislation.

The only other thing that I'd like to emphasize, Mr. Chairman, is that the Sierra Club is not opposed to making the kinds of changes that may need to be made in order to assure that operating mines or mines that are extremely close to operation do not have to be relinquished as a result of what would be assumed to be a technical violation of the law.

And in putting some force behind those comments, I would note that we have several pages of the testimony in which we talk about what we believe the principles of potential alternative diligence mechanisms might be. But I would again like to emphasize that the bills that we've seen so far don't cut the mustard. They're not bills that are designed to resolve the small problems. They're bills that are designed to overhaul the whole system and essentially to solve the big problem, to solve the problem that Mr. Brown from the Consolidation Coal Co. represented, which is the problem of a company that has 1.2 or 1.3 billion tons of Federal coal which it hasn't developed and doesn't have any plans to develop in the immediate future.

That's the kind of problem that we don't believe the Congress should be worrying about how to solve. The Congress worried about how to solve that in 1976. And they did the right thing.

Thank you very much.

[The prepared statement of Mr. Yeager follows:]

STATEMENT OF BROOKS B. YEAGER, WASHINGTON REPRESENTATIVE, THE SIERRA CLUB

Mr. Chairman, Members of the Subcommittee,

Thank you for the opportunity to come before you today to present the views of the Sierra Club concerning legislation to amend the diligence requirements of Federal coal law, including S. 570, the bill by Senator Wallop, S. 372, the bill by Senator Johnston, S. 946, by Senator Ford, and Printed Amendments Nos. 801 and 802, by Chairman McClure.

As you know, the Sierra Club has long held a deep and abiding interest in the management of America's public lands and the environmental consequences of the federal government's land management policies. We have closely followed developments in the Department of the Interior's coal management program. Along with other environmental groups, we supported the compromise coal program set out in 1979 by Secretary Andrus. We opposed the radical changes in that program instituted by Secretary Watt, and are parties to a lawsuit to overturn his 1982 regulatory revisions (*Natural Resources Defense Council v. Burford*, Civil No. 82-2763, District of D.C.) We supported the moratorium on further coal sales enacted by Congress in 1983, and we worked with the Linowes Commission and the Office of Technology Assessment in their evaluations of the program.

The three bills pending before the Subcommittee, like similar measures before the House Interior Committee, would make broad-ranging modifications in the provisions of federal coal law governing the so-called "diligence requirements" for the development of federal coal leases. The modifications would affect both the operative diligence requirement for leases issued after 1976, and the statutory development requirements for older leases. In general, the enactment of these bills would represent a significant, and, we believe, unwise retreat from the considered Congressional position on diligence which was established by the enactment, over President Ford's veto, of the Federal Coal Leasing Amendments Act of 1976 (FCLAA).

There may be instances in which companies which have made a good faith effort to comply with Section 3, and which are in fact producing coal from their leases, are legitimately concerned that they will be found in technical violation of the Section after August 4 of next year.

The Sierra Club does not advocate the forced relinquishment of operating leases as a result of such "technical" violations. We believe that such instances, should they arise, can be dealt with administratively. n any case, the legislation before the Subcommittee goes far beyond any language necessary to solve such peripheral problems.

Indeed, the three pending bills, if enacted, would effectively remove the teeth of Section 3, and would gut the only statutory provisions currently available to enforce diligence requirements against pre-1976 coal leases. In doing so, they would allow giant coal and oil companies to continue to speculate on billion of tons of Federal coal, in defiance of Congress' clear intent to end such speculation. They would relieve these same companies of any impetus to relinquish their non-complying leases to the government, and would thus prevent the government from rectifying, in many cases, the mistake of leasing environmentally unacceptable tracts.

Instead of penalizing corporations which have adopted a deliberate strategy of violating the spirit of FCLAA, these bills would reward such violators with financial windfalls which may be substantial, if difficult to quantify. Finally, by effectively releasing into the western coal markets billions of tons of coal reserves which might otherwise be relinquished, these bills may exacerbate the depression in the national coal reserve market, and may have unintended and untoward effects on the ability of other regions to compete for new coal coutracts.

In addition to the three bills under discussion, the Subcommittee has invited comment on two amendments introduced by Chairman McClure, which would effectively repeal Section 2(c) of the Mineral Lands Leasing Act, the section which now prohibits the issuance of Federal coal leases to land grant railroads or their affiliates.

The Sierra Club is concerned by the potential environmental and market impacts of repealing or substantially weakening the Section 2(c) prohibition. Though the argument has been raised that repeal would in fact have beneficial market impacts, this argument is clearly subject to dispute.

TWO MYTHS CONCERNING SECTION 3, OR, THE INEPT 94TH AND THE "CHAOS" THEORY:

Most of the points I would like to make today concern the debate over Section 3 of FCLAA, the specific provision through which Congress hoped to enforce its intent that pre-FCLAA coal leases be either developed, relinquished, or transferred to an entity which will develop them within 10 years after the passage of the Act.

There are two myths concerning Section 3 that have been widely propagated in recent weeks. The first is that Congress didn't know what it was doing when it enacted the Section. The second is that the enforcement of Section 3 as written will cause "chaos" in mineral leasing throughout the west. The first of these statements is clearly false, and the second, emanating as it is from the Administration officials most directly responsible for enforcing the law, has the character of a self-fulfilling prophecy.

Chairman Mo Udall of the House Interior Committee concisely described the purposes for which Congress enacted Section 3 in his speech to the American Mining Congress in February:

> But remember this -- Section 3 and Section 7 were viewed as mechanisms to force diligence -- to avoid speculation -- to require production -- and to avoid the abuses of the past, where leases were held almost indefinitely without any production or intent produce.

There is a clear public interest served by the requirement that federal coal leased to private interests be diligently developed. As expressed by former Secretary of the Interior Rogers C.B. Morton, and concurred in by the Senate Committee on Interior and Insular Affairs, in its report on the Federal Coal Leasing Amendments Act of 1975 (S. Rept.

94-296, July 23, 1975), the "overriding goals" of federal coal leasing should be:

> " * * * to assure environmental protection and the reclamation of mined land.
>
> To provide for orderly and timely resource development based on comprehensive land use planning.
>
> To assure a fair market value return for the resources sold."

The Committee further indicated that it believed a rigorous diligence requirement to be a key element in the achievement of these goals:

> The Committee believes that the purpose of leasing Federal coal is to have that coal produced to meet the nation's energy needs. The existing law has been interpreted to allow lessees to hold leases without production for as long as they see fit...
>
> The Committee recognizes that there may be other changes in the law relating to coal leasing which should be considered... At the same time, the Committee is convinced that there is a critical need to make the changes provided by S. 391 before the Department of the Interior embarks on any large-scale leasing program. Otherwise, billions of tons of coal may be placed into private hands under a law... which all agree is outmoded and not in the public interest.

Similarly, in its report on H.R. 6721, the House Interior and Insular Affairs Committee spelled out the linkage between diligence and the public interest (House Rept. 94-681, November 21, 1975). Taking note of the fact that 16 billion tons of the public's coal had been under lease and available for development since 1970, the Committee emphasized its dissatisfaction with the meager rate at which the coal was being developed, and its doubts that the leaseholders were "developing this resource at the most effective and efficient rate possible." In explicitly addressing this problem, the Committee noted its intent to prohibit the acquisition of "any new Federal leases" by lessees who failed to diligently develop the coal leases they had acquired under the old leasing laws.

In addition to the purposes for which it was intended, the enforcement of Section 3 is likely to produce significant benefits not contemplated at the time of its enactment. Prior to the passage of FCLAA, there was no statutory requirement that the government receive fair market value for the lease of the public's coal. As a result, the pre-'76 leases were issued with extremely low royalty rates, and often without any competitive or bonus bidding whatsoever. Because they were issued prior to the advent of comprehensive land-use planning, some of them also pose severe environmental conflicts. In the absence of Section 3, these leases will continue in force, in some instances well into the next century.

On the other hand, the enforcement of Section 3 will allow the Federal government to recoup millions of dollars in lost revenue through the re-sale of non-diligent leases, as well as to avert the environmental damage which may result from the strip-mining of environmentally sensitive tracts. The Sierra Club testified in detail concerning these benefits last year before the House Subcommittee on Mining and Natural Resources.

Congress evidently not only knew what it was doing in enacting Section 3, but understood the implications of its penalty provisions for non-complying lessees and considered them appropriate to the task at hand. What Congress failed to reckon with, arguably, was an Interior Department bureaucracy more interested in protecting its coal industry clients than in administering the law in an efficient and equitable manner.

The Interior Department has had nine years to consider the most effective method of enforcing Section 3, to formulate a rational method for identifying potentially non-compliant lessees, to evaluate the specific impacts of enforcement, and in general to prepare to effectively administer the law. Instead, it has chosen to wait until the last possible moment to even propose guidelines identifying in the abstract those entities which may be subject to enforcement, and to issue the most basic Solicitor's opinion addressing some of the underlying legal issues. Now, with the simple cry of impending chaos, the Department brazenly uses its lack of preparation as an argument for repealing the law itself.

The claim made by representatives of the Department that the enforcement of Section 3 as written will cause "chaos" in Interior's other mineral leasing programs, and in the western energy industry, is disingenuous, self-serving, and, more than possibly, self-fulfilling.

As far as we are aware, the Department has not advanced any proposals to deal with the practical problems which it alleges will arise in connection with the enforcement of Section 3. Indeed, the recent Section 3 guidelines fail to even discuss such practical enforcement issues as how the Department intends to identify affiliates of non-compliant lessees, and in what manner other mineral leasing programs will be audited to ensure the exclusion of disqualified bidders. Instead, Department representatives rest content with the unqualified assertion that "hundreds" of mineral companies will be excluded from the Federal leasing program.

Finally, it is particularly ironic for the Department to claim, as it has, that the enforcement of Section 3 will cause chaos in the onshore oil and gas leasing program. As this Committee well knows, that program is already in such administrative chaos that the Congress is contemplating the elimination of the non-competitive leasing system altogether.

WHO OWNS THE NON-DILIGENT PRE-1976 LEASES?

Section 3 was enacted for a clear purpose -- to end a prevalent practice of speculation on federal coal reserves. Although the ownership patterns of the pre-FCLAA leases have changed significantly since 1976, the problem of speculation still exists, as demonstrated by the extremely large blocs of undeveloped reserves held by the major reserve holders.

Of the 518 leases issued prior to 1976, only about 150 are actually in production or associated with producing leases. In addition, close to 100 are not subject to Section 3 penalties in 1986 because they have been assigned in the interim period.

Of the approximately 270 leases which may be subject to Section 3 penalties in 1986, 109 are held by the top 4 reserve holders: Gulf, Consolidation Coal (owned by Conoco), Utah International, and a consortium of California utilities. This top-heavy concentration of ownership proceeds down the line: three quarters of all the potential non-compliance leases, or over 200 leases, are held by the top 16 reserve holders.

Last year, in preparation for hearings before the House Subcommittee on Mining and Natural Resources, the Sierra Club published a report on the implications of the concentrated ownership of these old leases (Old Leases - New Giveaway: The Effort to Repeal Section 3 of the Federal Coal Lease Amendments Act, Sierra Club, June 18, 1984). Although some of the details of that report have become dated due to corporate mergers and the assignment of individual leases, its primary conclusion -- that the repeal of Section 3 would likely result in a speculative windfall for a few giant corporate reserve holders -- remains our conclusion today.

The argument that energy companies, as opposed to brokers, are inherently incapable of speculation in Federal coal, is hard to countenance. Of the largest pre-'76 reserve holders, only Gulf is currently producing significant amounts of Federal coal. Consolidation and Utah International, although both are major coal mining concerns, produce virtually nothing from their own Federal leases. In fact, any reasonable analysis must conclude that, since the passage of FCLAA, the major activity to which these reserves have been subject is to be shuffled around among various companies through sale, acquisition, and merger.

THE SECTION 3 DILIGENCE PENALTY: UNFAIR?

The key element of Section 3 is the penalty provision, which stipulates that any entity which holds, and has held for 10 years, a Federal coal lease, and which is not producing commercial quantities of coal from the lease, is prohibited from obtaining new mineral leases, including oil and gas leases, issued under the provisions of the Mineral Lands Leasing Act.

This provision has been characterized by the industry as onerous and unjust. However, as a consequence of the fact that the Federal coal reserve markets are dominated by a few diversified energy corporations, with significant interest in the Federal oil and gas leasing system, this provision constitutes a uniquely effective diligence mechanism. Without it, some of the largest coal reserve holders, whose need for further Federal coal leases is arguable, would have little or no incentive to achieve diligence on their existing leaseholds. This potential effectiveness, in enforcing the Congressional intent that non-diligent pre-FCLAA leases be either developed or relinquished by August 1986, is precisely why the "other mineral" penalty is under such strong attack from the industry.

Section 3 is, in general, an appropriate and necessary mechanism for enforcing the Congressional desire that pre-FCLAA leases be developed, relinquished, or transferred to an entity that will develop them, by a date certain. However, it clearly was not the intent of Congress to force the relinquishment or transfer of leases already in legitimate production. Therefore, there may be a need to allow flexibility for the few specific cases in which leaseholders are actually producing coal from the leasehold, but who may, as a result of circumstance, still not meet the commercial quantities threshold by the requisite date. In most, if not all, cases, such accommodation should be available administratively. This is particularly true in the context of the Department's proposed guidelines for the implementation of the section.

Under these proposed guidelines, only those leases which are not producing at all, and not under administrative suspension, will be subject to Section 3 enforcement action, and then only if and when the non-compliant lessee attempts to lease new coal or other Federal minerals. As a result of a convoluted definition of "producing in commercial quantities", which keys production to an indefinite "10-year bracket", leases in any sort of production are likely to be exempted from the penalty. Whether or not these guidelines correctly interpret the intent of Congress that pre-1976 leases should be either developed or relinquished within 10 years of the passage of FCLAA, which is arguable, they almost certainly accommodate the few cases in which actually producing mines, such as Mobil's Rojo Caballo Mine, might have been subject to Section 3 enforcement.

PRINCIPLES OF ALTERNATIVE DILIGENCE MECHANISMS

The Sierra Club believes that Congress knew what it was doing when it enacted Section 3; that, despite some changes in ownership, the problem of speculation in Federal coal is still substantial; that Section 3 can be effectively enforced without engendering administrative or market chaos; and that the equitable enforcement of Section 3 is as much in the public interest now as its enactment was in 1976. However, in order to assist the Committee in evaluating the various alternative diligence requirements which have been, or may be, suggested, it may be useful to note the basic principles which we feel must underlie any effective diligence provision for the so-called "old" coal leases:

1) The mechanism must effectively segregate leases with only speculative development potential from those whose development is actively underway, and must force the relinquishment or transfer of leases in the first category;

2) The mechanism should encourage the relinquishment of environmentally unsound leases -- if such leases are extended, they should be subject to the application of land-use planning and the unsuitability criteria;

3) The mechanism should force an early "fish or cut bait" decision, and should not allow non-compliant leases to be held indefinitely;

4) The mechanism should not favor some sectors of the industry, or some companies, with a new competitive advantage; and

5) The mechanism should ensure that the terms of any pre-FCLAA leases extended past the 1986 deadline are brought into equivalence with the lease terms mandated for new leases by FCLAA, it should ensure the full recovery of any revenue lost to the Federal Government through lease extension, and it should prevent reserve holders from obtaining excessive windfall profits.

COMMENTS ON INDIVIDUAL LEGISLATIVE PROPOSALS

The bills before the Subcommittee, S. 372, S. 570, and S. 946, seek to relax the burden which Section 3 allegedly poses to the industry, although they take somewhat different approaches to the problem. S. 570 would repeal the Section entirely and would not offer any substitute language in its place. Instead, the bill would rely on the operation of an amended Section 7 to force diligent development of pre-FCLAA leases, which would only be covered by a diligence requirement after their first readjustment subsequent to the passage of the legislation. This would mean that many pre-'76 leases would not face diligence deadlines until well past the year 2000.

In examining the regulatory revision of the diligence rules for pre-'76 leases imposed by Secretary Watt in 1982, the Linowes Commission found that the relaxed requirements:

> ...conferred a windfall gain on these leaseholders that was unnecessarily generous. The Interior Department decided to allow pre-1976 leaseholders to retain their leases in order to maintain an ample supply of Federal coal reserves under lease. This approach was neither equitable to the Government nor economically efficient.
>
> (Report of the Commission on Fair Market Value for Federal Coal Leasing, February 1984, p. 300)

If the weakening of the 1976 diligence regulations conferred a windfall on the owners of the pre-'76 leases, the repeal of Section 3 will compound that windfall. Such an approach represents a repudiation of the Congressional intent embodied in FCLAA and is, in our belief, contrary to the public interest in the efficient management of its resources.

S. 372, the bill introduced by Senator Johnston, proposes to effectively repeal the Section 3 diligence mechanism, to limit the penalty for non-compliance to a prohibition against obtaining further coal properties, and to offer holders of nonproducing pre-'76 leases a number of options which would allow them to retain the leases and still obtain further coal leases from the Federal government.

According to OTA, out of 502 'old' Federal coal leases, issued prior to the passage of the Federal Coal Lease Amendments Act in 1976 (FCLAA), over 200, covering more than 300,000 acres of public and private lands and containing over 7 billion tons of coal, will fail to meet FCLAA's requirements for diligent development by 1986. Section 3 of FCLAA requires that such leases be producing commercial quantities of coal within 10 years of FCLAA's enactment. Leaseholders failing to meet this 'diligent development' requirement must either relinquish or otherwise transfer their non-diligent leases, or forego the right to obtain other Federal mineral leases under the provisions of the Mineral Leasing Act of 1920.

S. 372 would significantly amend Section 3, limiting the diligence penalty to the acquisition of new coal leases, allowing non-diligent leaseholders to obtain new coal leases upon the payment of advance royalties, and offering various options through which non-diligent leaseholders could continue holding their old leases while still avoiding the diligence penalties of the current law. Some implications of these amendments are discussed below.

Limiting the ban on additional federal mineral lease acquisitions by non-diligent coal lessees to future coal leases only severely weakens the effectiveness of Section 3 as a diligence-enforcing mechanism. Nearly 45% of these non-diligent reserves, or over 3.2 billion tons of Federal coal, are held by seven major oil corporations. Corporations holding such huge reserve margins have little need for new Federal coal leases, but they do want to continue leasing other minerals. A "new coal only" ban, without any additional diligence enforcing mechanisms, will leave only Secretary Watt's 1982 diligence regulations for old leases to actually encourage development in such cases (i.e. no effective diligence deadline until 10 years after lease readjustment).

S. 372 would also allow non-diligent leaseholders to avoid even the prohibition on acquiring new coal properties if a) they hold no more than two non-diligent Federal coal leases, and agree to pay additional rental fees on their newly acquired leases, or b) they "turn back" non-diligent coal in amounts roughly equivalent to the reserves in their newly acquired leases, without regard to coal value, quality, or location.

Predicating the two new diligence mechanisms (i.e. "turnback" and rental fees) on successful bids for new leases does little to solve the diligence problem on old leases. Basically, these options have no effect unless the non-diligent leaseholder wants to acquire new federal coal properties. If the intent of the diligence mechanism is to force the timely development of leased lands, or, alternatively, the relinquishment of previously leased lands with little development potential, the mechanism should directly affect the existing leaseholder, *based on the status of the existing lease.*

Applying the rental fee to newly leased lands also raises problems regarding the distribution of the additional rental. Although the state in which the non-diligent lease is located is receiving no production royalty from the lease, the assessment of advance royalties on non-diligent leases would at least provide a revenue stream. The assessment of additional rentals against new leases provides no such revenue, especially since the new lease may be in a different state entirely.

Allowing non-diligent leaseholders to trade in their old leases for newly-acquired reserves, without regard to the quality or the marketability of the coal, invites further Federal revenue losses. Thus, a corporation holding billions of tons of non-diligent Federal coal could relinquish its 'dog' leases, hold on to reserves that have speculative value, and still bid for new competitive leases. This provision encourages exactly the kind of large-scale speculation which

Section 3 was enacted to prevent.

The rental fee itself seems far too low, either to encourage the development of non-diligent holdings, or to increase the attractiveness of the turnback option versus the payment option. Under the proposed scheme, assuming a corporation holding 2,000 acres of non-diligent federal coal, a payment of $90,000 per year would be sufficient to allow the acquisition of a new 2,000 acre tract with 300 million + tons of new coal, for a total additional fee of .03 cents/ton.

S. 372 would also significantly amend current statutory requirements for the diligent development of newly acquired Federal coal leases, contained in Sec. 7 of FCLAA. Similar to other diligence provisions of Federal Mineral law, Section 7 currently requires any newly acquired lease to be brought into commercial production within 10 years of issuance, or to be cancelled. S. 372 would amend this requirement to allow new leases to be held indefinitely, without production, upon the payment of advance royalties. The advance royalties would be assessed on an escalating scale from the 10th year to the 20th year, and would be fully refundable against later production royalties.

Allowing corporations to hold non-diligent leases indefinitely defeats the basic purpose of diligence requirements in general. Unless the advance royalty assessed against such leases is a) non-refundable, and b) sufficient to provide real financial penalties for non-compliance, such a scheme effectively encourages speculation with the payment of a nominal carrying charge. Nominal advance royalty payments may be far better afforded by large corporate leaseholders than by the small mining corporations which must compete against them.

S. 372's advance royalty schedule is far lower than comparable proposals advanced by the Linowes Commission. S.372 would allow a leaseholder 20 years to reach a payment level equivalent to production royalties based on 1% of production. Even the Linowes Commission schedule, starting at .5%, reached 2 1/2% in the 16th year, rather than

1% in the 21st year.

S. 372 also contains a number of other worrisome provisions. It defines "commercial quantities" - the amount of coal which must be produced annually in order to meet diligent development requirements - as 1% of the coal reserves under lease or within a logical mining unit (LMU). This definition could be improved if "commercial quantities" were referenced to some legitimate notion of projected mine-life; for this purpose, 40 year mine-life and 2 1/2% per year seem more appropriate than 100 year mine-life and 1% per year.

S. 372 would define "competitive bidding" as the receipt of two or more bids, but would exempt maintenance and by-pass lease tracts from the current legal requirement that all leasing be by competitive bid. The bill would also direct the Interior Department to establish regulations for the negotiated sale of maintenance and by-pass tracts on an experimental basis.

The Linowes Commission identified several serious problems with the current legal requirement that maintenance and by-pass tracts, which are normally of interest to only one operator, be sold exclusively by competitive bid. However, allowing experimentation with negotiated sales without any statutory direction appears to be a reckless grant of authority to a Department which has shown itself ill-prepared to protect the public interest or the Federal treasury in the administration of Federal mineral leasing programs.

Without further definition of what constitutes a legitimate maintenance tract, the simple fact that most coal reserves in operating mining areas can be delineated in a way tailor-made as an add-on to an operating mine offers plentiful opportunities for the abuse of administrative discretion. In recent major sales, such as the Powder River Sale, the majority of tracts have been delineated as 'maintenance tracts'. Some of these delineations have been, for good reason, highly controversial. In fact, there are several interesting alternatives, including the use of so-called 'intertract bidding', in which maintenance tracts could be leased through a quasi-competitive system, which may offer better solutions to the maintenance lease dilemma than a wholesale move to negotiated sales.

S. 946, the legislation introduced by Senator Ford, eschews broad revisions to Section 3 in favor of a simple change which would limit the penalty to non-complying lessees from the current bar on acquiring any other Federal mineral leases to a ban on acquiring new competitive coal leases. Though this change might appear minor, it is in fact quite profound. In addition to the implications of eliminating the penalty against oil and gas leasing, which have been discussed in connection with Senator Johnston's bill, this change would further narrow the penalty to only new competitive leases. Since the great majority of leases currently issued are in fact maintenance, by-pass, or emergency leases, this change essentially guts the penalty provision of the law.

Printed Amendments Nos. 801 and 802, introduced by Chairman McClure, would substantially modify and effectively repeal the current prohibition against issuing Federal coal leases to land-grant railroads or their affiliates which is contained in Section 2(c) of the Mineral Lands Leasing Act. In his introductory statement of October 17, Chairman McClure asserts that Section 2(c) is archaic, and cites numerous reviews and studies, including the recent Linowes Commission Report, which have allegedly recommended its repeal.

Although the Public Land Law Review Commission and the Justice Department have indeed recommended the repeal of Section 2(c), the record should note that the Linowes Commission did not. Two members of the Commission, Chairman Linowes and Commissioner Walsh, stated their opinion that a modification of the Section which allowed railroad leasing subject to a requirement for cooperative leasing of the contiguous Federal and railroad-owned tracts would help achieve the goal of developing coal in the checkerboard areas. The three other commissioners recused themselves from any recommendations on the issue of railroad leasing of Federal coal. (Cf. Linowes Commission, Op. Cit., p. 343).

More importantly, the Linowes Commission clearly had some doubts about the supposed competitive advantages from repealing the Section:

> To the extent that the railroads would limit their bidding to their own checkerboard areas, competition for individual leases is not likely to be much increased by the repeal of Section 2(c). For these tracts, the railroad's advantage in assembling a logical mining unit would discourage other potential bidders. On tracts within the railroad checkerboard, repeal of Section 2(c) may simply displace multiple bidders in favor of the railroad. Such tracts would become similar to other captive Federal tracts that typically draw only one bid from the coal company holding adjacent coal. (Linowes Commission, Op. Cit., p. 342).

If the competitive impacts of repealing Section 2(c) are unclear, so are the environmental consequences. What is clear is that such a repeal would open the possibility of development of over 16 billion tons of coal in the checkerboard areas. Although the pace of such development would be decided largely by market forces, its environmental impacts deserve extremely careful consideration before any legislative action on Section 2(c) is taken by the Congress.

CONCLUSION

The problem of speculation in Federal coal which caused Congress to enact Section 3 in 1976 has not changed appreciably in the intervening nine years. The ownership of vast reserves of the public's coal is still concentrated in a few hands, and, despite the fact that many of the leaseholds have now been in private hands for 20 years or more, only a small portion are actually under development.

The equitable enforcement of a rigorous diligence requirement for these old leases is as much in the public interest now as it was in 1976. Contrary to the arguments of Department representatives, enforcement will result, not in the disqualification of major energy corporations from further mineral leasing, but instead in the relinquishment of large blocs of unmarketable and environmentally unsound leases.

Although the Administration and the coal industry have attempted to foment a crisis atmosphere in which drastic amendments to Section 3 will seem both inevitable and well-justified, there is, in reality, no reason for panic. No one wishes to see the forced relinquishment of operating mines or mines with the immediate prospect of commercial production. But such cases, to the extent they exist, can be accommodated administratively. Certainly they do not require the major legislative overhaul which is contemplated by the legislation currently before the Subcommittee.

Finally, it is evident that the alternatives proposed to Section 3 so far suffer, one and all, from the fatal defect of favoring some parts of the industry against others, and the industry as a whole against the interest of the public. The Congress owes it to itself to carefully examine the specific implications of each of these proposals before going forward with legislation.

The CHAIRMAN. Thank you, Mr. Yeager
Mr. Masselli.

STATEMENT OF DAVID MASSELLI, WASHINGTON COUNSEL, WESTERN ORGANIZATION OF RESOURCE COUNCILS

Mr. MASSELLI. Thank you, Mr. Chairman. I will summarize my prepared testimony. I'm David Masselli and I am Washington counsel of the Western Organization of Resource Councils which is a regional coalition of citizen groups in Wyoming, North Dakota, Montana, and Colorado.

We appreciate the opportunity to present our views on the pending legislation to amend the Mineral Leasing Act. The most important provisions of our proposed legislation would amend sections 3 and 7 of the Federal Coal Leasing Act Amendments of 1976 and section 2(c) of the Mineral Leasing Act which prohibits common carrier railroads and their affiliates from withholding Federal coal leasing.

We strongly oppose changes to section 3 and section 7. Let me comment briefly on both of them and let me turn first to section 3. The pending legislative proposals would confer an unwarranted windfall on the segment of the coal industry such as Consolidation Coal, Utah International, and so on, which has most assiduously avoided diligent development, thereby unfairly penalizing companies which have complied.

Mr. Chairman, what we're dealing with today is a legacy of the 1960's when hundreds of coal leases were granted without adequate planning, without sufficient concern for environmental values, without any consideration of the rights of surface owners, and frankly they were given away for a song.

In 1976, Congress looked at these leases which weren't being developed, and many of which shouldn't have been issued in the first place. The Federal Coal Leasing Act Amendments established new procedures so that the errors of the past might not be repeated. Most of it looked to the future.

But section 3 was a damage-control operation. It looked at those 500 existing leases and said either develop this coal in the the near term to meet our national energy needs, or we're going to devise a mechanism that will make it in your interest to get rid of them.

To repeal section 3 now would continue in existence for another 30 years on average those leases granted in the 1960's. It would also have the potential to deprive impacted States and localities of needed revenues. We're particularly concerned that the current formulations of the proposals before us, especially the turnback proposal, give the greatest benefits to those who are holding the most leases and the most environmentally damaging leases.

It's almost as if the legislation was designed to make it easiest on the least deserving.

We've analyzed the companies that would be most hard hit by section 3—companies like Gulf Oil, Consolidation Coal, Utah International, and Malapai Resources. However, you slice it, these companies are speculating in Federal Coal. Although their leases were acquired 20 years ago and were generally acquired for next to nothing, Consolidation leases an average of 30 cents an acre, one-ten thousandth of 1 cent a ton. And although these leases were available for development during the enormous coal boom of the 1970's, they haven't developed them.

When you look at the top 10 holders of section 3 leases, they average 1 producing pre-FCLAA lease for every 27 held. Many of these companies mine an awful lot of coal, such as Consolidated. They're major coal producers in the East on private lands or as contract operators, but they're just not developing their pre-FCLAA leases. Consolidated has 1 currently producing Federal lease for over 30 nonproducing leases. Utah International has one lease for 20. And the three Caparowitz leaseholders, Mono, New Albion, and Malapai, hold 21 nonproducing leases which they got for nothing, and no producing leases.

We're at somewhat of a loss to see why we should enact special-purpose legislation to benefit this small group of companies, particularly when other coal companies have developed their leases.

Turning to section 3—to section 2(c)—let me just say that we were treated, I believe before you came in, to a rather entertaining interchange between the railroads and the coal companies. Whoever scheduled that panel may have a great future as a promoter in the World Wrestling Federation.

I must admit that I believe the coal companies when they talked about section 2(c), and the railroads when they talked about section 3.

However, I would like to point out that there are other issues related to section 2(c) besides the competition question. Mr. McCormick talked about changes since 1976 and I am in agreement that there have been changes. One change that's very significant since 1976 is that the three great land-grant railroads have all created holding company systems whereby the rails have been divorced from the land which was originally given to the rails in order to maintain those lines.

And at the very time that land-grant railroads seek the ability to get into coal production, they continue to abandon hundreds of miles of spur and branch lines serving agricultural communities. And when you ask them why, they say: "Well, we're not making any money. This railroad doesn't have any assets." Of course, the reason the railroad doesn't have any assets is that it gave the assets for a piece of paper to its sister holding company.

We think that any legislation that deals with the question of whether railroads should be be able to lease in the checkerboarded areas should be developed in the context of a look at the entire behavior of the land-grant railroads, and we think that just splitting off section 2(c) from questions like spur abandonment and from the whole question of the wisdom of creating this mechanism with the holding companies is legislatively perhaps not the way to go.

With respect to section 7, I would like to second the comments of Mr. Yeager. We don't think that the legislation before us is right, but we think that there should be changes in section 7 diligence. We think there can be changes. And frankly, when I look at the legislation, I think that we may not be that far apart. And I think section 7 is a really important section because that talks particularly about the impact of section 7 on post-1976 leaseholders, people who paid good money for leases, people who got leases that went through environmental screening, people that bid in competitive leasing.

And I, for one, am not about to say that if you hold a lease for 10 years and 1 day, that someone is going to come and sweep it away from you. And we have suggested a series of possible changes to the legislative language which is before us in the two bills.

I must say that one of the great difficulties in dealing with section 7 extensions is our concern that they would be granted to pre-1976 leases. We certainly look with much more favor on granting them to post-1976 leases.

Finally, I would like to just mention in passing that to the surprise of almost everyone, the House of Representatives, a subcommittee of the House that was hearing legislation on similar legislation, adopted a provision which would have provided for a royalty rollback for leases issued before 1976. It isn't enough that we gave them the leases for nothing. Now we're going to let them pay less money than people who bought leases after 1976.

I noted that no one on that subcommittee was from any of the producing States. Our analysis is that that kind of rollback would cost the Federal Treasury about a half billion dollars over the next 5 years and would cost the six major coal-producing States in the West another half billion dollars.

And I would hope that if the Department—I know the witnesses are going to be discussing this issue. I hope that if this committee looks at this issue, that it get the input of the States as it has done by getting Mr. Bardacke, and also that it get the input of the Office of Management and Budget, because in these days I think a half a billion dollars is a lot.

That concludes my statement. Thank you very much.

[The prepared statement of Mr. Masselli follows:]

STATEMENT OF DAVID MASSELLI, WASHINGTON COUNSEL, WESTERN ORGANIZATION OF RESOURCE COUNCILS

The Western Organization of Resource Councils appreciates this opportunity to present its views on S. 570, S. 372 and S. 946, bills to amend the Mineral Leasing Act. The most important provisions of the proposed legislation would amend Sections 3 and 7 of the Federal Coal Leasing Amendments Act ("FCLAA") of 1976, more commonly known as the coal leasing diligence provisions. Proposals to amend these two provisions -- particularly proposals to amend Section 3 which applies to coal leases issued before 1976 -- are extremely controversial.

The Western Organization of Resource Councils (WORC) is a regional association composed of the Northern Plains Resource Council (Montana), the Powder River Basin Resource Council (Wyoming), the Dakota Resource Council (North Dakaota) and the Western Colorado Congress. Our members live and work in those areas of the West most directly impacted by coal development, particularly the development of Federal coal reserves. For this reason, we have long had a deep involvement in both the Federal coal management program and the Federal surface mining and reclamation program. Decisions made by Congress and the Executive Branch concerning the ground rules for Western coal mining can dramatically effect our communities, our lifestyle, and, in some cases, what happens on the land we live on.

The Western Organization of Resource Councils has carefully reviewed the proposed legislation, particularly insofar as it would amend Section 3. We find the pending legislative proposals totally unacceptable. They would confer an unwarranted windfall on the one segment of the coal industry which has most assiduously avoided diligent development, thereby unfairly penalizing companies which have complied. They would allow many leases improvidently granted in the 1960's -- without adequate planning, without sufficient concern for environmental values, and without any consideration of the rights of surface owners, lessees and permittees -- to continue in existence for another thirty years, on average. They have the potential to deprive impacted states and localities of needed revenues.

We are particularly concerned that the current formulation of the legislative proposals would give the greatest benefits to those who are holding the most leases and the most environmentally damaging leases. It is almost as if the legislation was designed to make it easiest on the least deserving.

The importance of Section 3 as the key means of ensuring diligent development of Federal coal leases has been heightened by two recent actions by the Department of the Interior which threaten to diminish the effectiveness of the Section 7 diligence provision. First, the inexplicable failure of the Department to properly readjust an undetermined number of leases may have the effect of insulating them from Section 7 for another twenty years (See Appendix 1). Second, the newly issued guidelines on Logical Mining Units seem to allow an unwarranted ten year extension to diligence. These two developments would, if anything, increase the importance of retaining Section 3.

We would like to make it quite clear that while we are committed to defending the goals and purposes of Section 3, we do not view it as a device to penalize leaseholders who are in the process of developing their leases. Section 3 should not be used to penalize leesses who have developed mines and are producing from them, nor should it be used to strike down the non-producing lease which is part of a producing mine. We don't think Section 3 does this. We believe that ambiguities and legitimate concerns can be resolved by the issuance of regulations. It is more than a little suspicious that many of the people who allege the possibility of such occurrences, offer legislative solutions which have little to do with the supposed problems, but which provide a blank check for those who have made no efforts to develop.

We have no sympathy whatsoever for companies which have held leases for more than fifteen years during an unprecedented boom in Western coal development and still do not produce from them. We believe that these companies should bear the brunt of Section 3 sanctions. The purposes for which Section 3 was enacted are as valid today as they were in 1976.

If this seems like an unduly hard position, so be it. The hysteria generated over Section 3 by a handful of coal companies can not alter the fact that their case is fatally flawed. As we will discuss below, there is no unfairness in implementing Section 3; if anything, it would be unfair to alter it and penalize those who conformed their behavior to the law while rewarding those who brazenly defied it. Nor will chaos attend the implementation of Section 3. While the mineral leasing programs of the Department of the Interior have often been marked by chaos and mismanagement, implementation of Section 3 can be accomplished in a relatively simple and straightforward manner.

To explain why we have taken the positions outlined above, we would like to briefly retrace the background of Section 3, to lay out the preliminary results of our analysis of the impacts of Section 3, to discuss in some detail the unfairness and chaos issues and also the problems with the so-called "turnback" alternative. After that, we will outline some principles for approaching the Section 7 diligence problem, an area where the grounds for concensus may exist. The statement will also examine the impacts of proposed reductions in the statutory royalty rate as it applies to old leases and proposals to amend Section 2(c) of the MLA which prohibits issuance of Federal coal leases to railroads and their affiliates. The statement closes with a more detailed analysis of S. 570. S.372 and S. 942, as well as an analysis of the legislation which has been proposed by a Subcommittee of the House Interior Committee.

I. Comments on Proposed Changes to Section 3.

Why Section 3?

It is very important to review the background which led to the enactment of Section 3 to understand why WORC opposes changes of the type proposed in pending legislation. The history of nondevelopment and speculation in Federal coal leases during the 1960's and 1970's compelled the fashioning of a legislative solution: Section 3 is that solution.

While the coal leasing program of the Mineral Leasing Act ("MLA") was established in 1920, leasing activity was relatively limited until the 1960's. For much of the period, leases were only issued to sustain pre-existing mining operations. Provisions in most leases called for development by the sixth year and often specified dollar amounts of investments that had to be made, on a year-by-year basis.

A burst of frenetic leasing activity which reached its height between 1965 and 1969 changed the traditional pattern of Western Federal coal leasing. By the end of that decade the number of leases had more than tripled to five hundred. Almost half had been issued without competition or bonus payments under the "preference right leasing" provision of the MLA which granted special rights to prospectors who found and proved up coal depositions in areas where commercial potential was not known. Surprisingly, most of these PRLA's were located in the Powder

River Basin area of Wyoming and Montana and the Price region of Utah -- areas widely recognized for their rich coal deposits. The so-called "competitive leasing" program was not much better. Only 30% of competitive leasing occurred during auctions with more than one bidder, the average bonus was a paltry $16.90 per acre and rents and royalties were extremely low. None of this coal leasing was subject to planning and the environmental protection provisions in leases were scant and inadequate.

Beginning in 1971, the Department of the Interior instituted a moratorium on further coal leasing. The Department recognized a growing public outcry over failings in its coal program and, in particular, over the fact that greater leasing was not accompanied by greater development of inexpensive coal-based energy supplies. Public attention was particularly galvanized by the publication of a study by the Council on Economic Priorities entitled "Leased and Lost" which revealed that only 54 of 474 Western coal leases were producing in 1973. Three hundred and twenty-one of these leases had never produced coal. Furthermore, most Federal coal leases were held by individuals who did not have the ability to mine them, but who were making great profits by selling them. This "speculative" holding of Federal coal leases created a strong movement for a complete overhaul of the Federal coal program.

The Department attempted a number of administrative "fixes" to the program, but none totally met the concerns of the public or Congress. When Congress acted to dramatically amend the Mineral Leasing Act in 1976, it addressed three major concerns:

(1) getting fair market value for public resources, (2) subjecting future coal leases to adequate environmental and economic planning, and (3) putting an end to the speculative holding of Federal coal leases. The House Report on the legislative changes contained extensive references to and quotations from "Leased and Lost".

FCLAA was, for the most part, prospective legislation applying only to newly issued leases. Some changes, such as higher minimum royalties and rentals, apply to old leases only after readjustment. Despite the outrage over the old leases and the concern that many should not have been granted, Congress was concerned about potential constitutional problems associated with changing the terms of existing leases.

But Congress would not and could not just leave the old leases intact. It was concerned that the Department of the Interior had not enforced the statutory condition of diligent development contained in the 1920 MLA. It was shocked by the fact that not one lease had ever been cancelled for a lack of compliance with that condition. Nor was it willing to wait until the ten year diligence period (found in Section 7) would apply to old leases. For most of the leases issued in the mid-60's Section 7 would not take effect until ten years after the first post-FCLAA readjustment, generally not having any impact before the mid-90's. Congress clearly found that wait too long.

The result was Section 3, a clever, constitutionally sound provision which did not directly impact the existing leases but which was designed to force the holder of a pre-FCLAA lease to produce from it, sell it or relinquish it by 1986. Because of constitutional concerns, Congress focused on future actions by holders of non-diligent leases. And to give Section 3 some bite, it deliberately extended the impact of Section 3 beyond coal leases, making the prohibition apply to any onshore Federal lease governed by the MLA.

Significantly, there was little opposition to the concept behind Section 3. President Ford's veto message addressed the concern that the Section 7 ten year period for new leases was too short and inflexible, but said nothing about the application of Section 3 to existing leases. Indeed, the Department had promulgated regulations in May, 1976 (43 CFR 3500.0-5(f) and 43 CFR 3520.2-5, May 28, 1976) which would have terminated all non-producing pre-FCLAA leases by 1986 irrespective of whether there had been any intervening assignments.

Section 3 was a statement by Congress that it wanted to take dramatic steps to discourage the holding of pre-FCLAA Federal coal leases. It was devised against a backdrop of concern over past abuses in the Federal coal program. The only leases that will be affected by Section 3 on August 4, 1986 are the same non-producing leases which were being held on August 4, 1976. These are the same leases which were issued with no bonus payment or with paltry bonuses, the same leases which contain minimal royalty provisions, the same leases with inadequate environmental protections, the same leases located in fragile areas or on the boundaries of National Parks -- and they are owned by the same people, who have held them for an additional ten years and not developed them. When we look at the movement to repeal or amend Section 3, we ask "What has changed in the past 10 years other than that the period of non-production is 10 years longer?"

Is There Still A Diligence Problem ?

There are some who will justify appeal or evisceration of Section 3 on the grounds that the "problem" -- defined as either non-diligence or speculation -- has gone away, so the remedy is no longer needed. The facts do not bear this out.

In April, 1985, the Department of the Interior released large portions of their Automated Coal Lease Data System ("ACLDS") to WORC in response to a Freedom of Information request. While not without its flaws, the ACLDS data gives a generally accurate picture of the development status of Federal coal leases.

First, it is critical to realize how the 'old' leases still dominate the base Federal coal leases. There are 628 Federal coal leases, over 600 in the states of Colorado, Montana, Oklahoma, New Mexico, North Dakota, Utah and Wyoming. 518 of these leases -- over 80% of the total -- were issued before August 4, 1976.

Of these 518 leases, only 101 were listed by ACLDS as producing in 1983 (this is the last year for which information is available; in a radical departure from past policy the Department is maintaining that 1984 production, royalty payment and royalty collection data is confidential). Thus less than 20% of the pre-FCLAA leases were producing, seven years after passage of FCLAA and fifteen years after the average date of lease issuance.

The remaining 417 leases included 98 leases which had produced at some time during their lifetime. Ten of these appeared to be leases that had been mined out, but not yet relinquished. Thus, according to the ACLDS data, 317 leases have never been mined at all. In other words, more than 60% of the leases whose non-development Congress sought to penalize 9 years ago remain undeveloped. Almost all of them are at least fifteen years old. All were available for development during the great Western coal boom of the mid-1970's.

The ACLDS data makes it clear that a sizeable percentage of pre-FCLAA leases are still being held without development. Because the facts are so stark, industry has developed a fallback argument -- that holding of non-producing leases no longer constitutes speculation because leases are being held by companies which have the wherewithal to produce.

This argument presumes that speculation is a function of who you are rather than what you do, a title rather than a course of conduct. In other words, small-town Western investors who buy coal leases and don't develop them, but sell them when the price is right, are evil speculators, while diversified energy companies who hold coal leases and don't develop them for fifteen years are not.

But again, the facts indicate that the behavior of the major holders of non-diligent leases is precisely that of speculators. When the ACLDS list of 319 leases which have never produced is examined, there are 390 lessee-lease relationships [because of multiple ownership, some leases are best viewed for purposes of Section 3 analysis as several leases, one for each owner]. There are 100 owners of these 390 leases, an average of four leases per owner. However, the top ten holders of non-diligent leases own 208 non-producing leases or an average of 21 each and the remaining 90 own an average of less than 2 each.

Top Ten Holders of Non-Producing, Pre-FCLAA Leases

Gulf Oil
Consolidation Coal
Utah International
Malapai Resources
Mono Power
New Albion Resources
Peabody Coal
Swanton Energy Resources
Evans Coal Company
Nevada Electric Investment

Furthermore, the major holders of non-diligent leases behave like speculators insofar as Federal coal leases are concerned. While all other holders of pre-FCIAA Federal leases average one currently producing lease for every three held, the "top ten" average one producing pre-FCLAA Federal lease for each twenty-seven held. Although several of the major Section 3 violators are major coal producers in the East, on private lands or as contract operators, they are clearly not developing any pre-FCLAA Federal coal leases. Thus, Consol has only one currently-producing Federal lease and over thirty non-producing Federal leases, Utah International also has only one producing lease and over twenty non-producing Federal leases, the three Kaiparowits leaseholders (Mono, New Albion and Malapai) jointly hold 21 non-producing leases and no producing leases.

An analysis of the leaseholdings of the major owners of non-producing leases reveals that very few of these leases have any development prospects in the next decade. Many of these leases are located in a remote area of Southern Utah in close proximity to the famed 'Golden Circle of Parks'.

This brief review of our preliminary results highlights two factors: (1) There is still a major diligence problem with pre-FCLAA leases, and (2) while many coal companies hold some non-diligent old leases, a small group of companies hold a disproportionately large share of undeveloped leases and a disproportionately small share of producing leases.

The Fairness Issue

Many of the companies who hold the largest number of leases with Section 3 problems base their request for amendment on the alleged "unfairness" of Section 3. For many years, some of these companies also claimed that Section 3 might be unconstitutional, as a violation of existing contractural agreements with the government and deprivation of property right. The recent Supreme Court decision in U.S. v Locke which resoundingly upheld Congressional power place new conditions on the exercise of rights involving Federal lands indicates that Congress may actually have powers which go far beyond those exercised in

Section 3.

Generally, the unfairness argument takes one of two forms: (1) Section 3 unfairly changed the rules of the game or (2) Section 3 will penalize companies that have been progressing towards development. Let us look at each of these two arguments.

1. The Rules of the Game. In essence, the "rules of the game" argument holds that Federal coal leases were always viewed as perpetual, that companies took them with that understanding and were encouraged to do so. Therefore, it is unfair to change the rules after a company has entered the Federal coal marketplace.

The main problem with this otherwise persuasive argument is that it is historically wrong. During the first forty years of the Mineral Leasing Act, it was generally quite difficult to get a Federal coal lease and sitting on it was discouraged. For many years, there was a policy to issue only what are now called emergency and maintenance leases. You couldn't get a Federal lease to start a new mine. After that policy was dropped, the Department required specified annual expenditures as a part of the lease and District Mining Supervisors checked those numbers every year.

Thus, people acquiring leases in the mid-1960's did not look around and see a history of stockpiled, non-producing leases. Indeed, the history was quite different and though there had been some policy changes made in the early 60's, there was absolutely nothing to indicate that the Federal government was going to allow anyone to sit on leases indefinitely.

In addition, notwithstanding what a lessee might be hearing at the local BLM office, both the MLA and his lease called for diligent development and continuous operation. Certainly any prudent lessee would realize that a subsequent Administration might reasonably interpret those regulations in a manner inconsistent with perpetual holding. This was precisely what the Ford Administration did in 1976.

2. The Unfair Penalty. The "unfair penalty" approach would have us believe that enforcement of Section 3 is sudden and surprising and that it disrupts a normal business planning process which would bring these leases into production, albeit on a slightly delayed basis.

This argument also conveniently overlooks a critical fact. From May, 1976 until July, 1982 the holders of pre-FCLAA leases were on notice that their leases would be terminated in 1986 if they were not producing. Those rules, referred to above and recodified in 1979 at 43 CFR 3475.4, required a production of 2 - 1/2% of lease reserves by August 4, 1986 to prevent lease termination. The change by the Watt Administration deleting that rule is still be challenged.

Hence, it is very likely that for most of the past eight years, the holders of pre-FCLAA leases with low development prospects have not wasted a great deal of thought or expenditure on them because they believed it highly likely that they would be terminated. Attention and expenditures were focused on the leases which could be developed before the 1986 deadline in the courts.

The Unfairness of Changing Section 3. Absent from most discussions of unfairness in the Section 3 debate has been much consideration of the unfairness that would attend any significant change in Section 3 -- the unfairness to those who conformed their behavior to the law.

If all coal companies had participated equally in stockpiling non-producing leases, this argument would have little weight. But all companies did not go on inventory holding binges; in fact such behavior seems rather aberrant.

Why not?

While reasons may vary from company to company, it seems certain that many companies refrained from inventory binges because they realized that they could not develop such reserves in any reasonable time frame. Other companies who held leases which would have been subject to Section 3 have already sold them on the assignment market, perhaps at prices somewhat lower than they might have wanted. Still others may have speeded up production schedules, at no little expense, in order to come into production.

In testimony before the House Subcommittee on Mining and Natural Resources, a representative of Peabody Coal Comoany indicated that his company was in the process of relinquishing 19 leases which would not be in compliance with Section 3. While this may be the most dramatic example, several other large coal companies have divested themselves of nonproducing pre-FCLAA leases by assignment or relinquishment.

Yet another class of the disadvantaged are those who have paid good money for post-FCLAA leases. Their long-term market analysis may well have been based on the assumption that certain reserves held by potential competitors would be relinquished or terminated after implementation of either the 1976 regulations or Section 3. If Section 3 is repealed or amended as currently proposed, they face the prospect of competition from reserves with a lower rental, royalty and bonus for many more years.

If the rules of the game are being unfairly changed on anybody, it is those who obeyed the law.

Will Enforcing Section 3 Lead to Chaos?

As the credibility of the unfairness argument has diminished, proponents of gutting Section 3 and the Department of the Interior have increasingly relied on a new argument: enforcing Section 3 in its current form will lead to chaos throughout the federal mineral leasing system. While we would be the last to underestimate the ability of the Department to generate chaos anywhere in the mineral leasing system, the fact is that this argument is pure hogwash. A few simple steps can make Section 3 almost self-enforcing.

The chaos argument has several components which were ennunciated by Deputy Assistant Secretary Griles in testimony before the House Subcommittee on Mining and Natural Resources on May 21 and June 4, 1985. The first emphasizes how difficult it is to determine who is not in compliance. The second concentrates on alleged difficulties in applying the no-leasing sanction to thousands of leases, particularly oil and gas leases, even when it is known who is not in compliance. A third maintains that enforcement of Section 3 will seriously diminish competition for Federal mineral leases. A fourth finds problems for those seeking emergency leases, production maintenance leases and preference right leases. Finally, Mr. Griles raised the "pending action" issues. How serious are these problems?

1. Which Leases Are in Violation

Let us turn first to the problem of identifying Section 3 violators. Note first that we are dealing with a limited and managable universe, 500 leases, 100 lessees. Any lease more than ten years old is in violation of Section 3 unless:

(1) It is producing in commercial quantities;

(2) It is part of a logical mining unit (LMU) which is producing in commercial quantities; or

(3) It has been held by its current owner for less than ten years.

It is quite easy to determine whether a lease meets criteria #1 or #2 above. Production in commercial quantities is defined in terms of the production of a percentage of reserves during a certain time period. For each lease, the Department has records of its reserves and its year-by-year production. It is a simple calculation to determine the required production amount and compare it with the actual production, if it is greater than the required amount, the lease is not covered.

For leases included in logical mining units, the process is the same except that the required amount and actual production are determined based on reserve and production amounts for the LMU rather than an individual lease.

At this point, we are left with leases more than ten years old which are not producing in commercial quantities. These leases are in violation of Section 3 unless the current holder of the lease has held it for less than 10 years. Valid arms-length assignments within the ten year period exempt the lease from Section 3 coverage.

The Department maintains that assessing the nature of assignments creates extraordinary difficulties. It is difficult to know how the Department has reached this conclusion as it did not deal with this question in its Section 3 guidelines.

The Department has records of all assignments and the date of each assignment. Using the ACLDS data provided us by the Department we were able to find 163 non-producing leases which had post-FCLAA assignments. Determining whether or not 99% of these assignments are between non-affiliated companies is relatively easy for anyone armed with the sort of material available at any public library, let alone to persons who are being paid by the taxpayer to monitor coal leasing. It is not all that difficult to determine that transfers between Gulf and Kemmerer were part of a purchase of the latter company by the former, not an arms-length sale of a lease.

The Department, of course, is not limited to such resources. It has the power to query a current leaseholder about its relationship to an assignor from which it received a lease.

Once the three operations described above are performed, it is relatively easy to generate a list of all lessees in violation of Section 3 and the particular leases for which the violation has occurred. Using the ACLDS data provided by the Department, plus our review of assignments based on the brief discussion in the Guidelines, WORC has been able to generate such a list on a small personal computer in approximately 10 minutes.

Apparently, the Department is able to perform a similar exercise when it feels that it must. In preparing its recent Federal Coal Management Program Final Environmental Impact Statement Supplement (October, 1985), where a failure to adequately identify the potential reserve base might have opened the FEISS to legal challenge, the Department stated that it had identified 229 pre-FCLAA leases which would be in non-compliance with Section 3 (Appendix 8, Coal Forecast Technical Details, Volume 2, p. A-530). It then performed a lease-by-lease analysis of the development potential of each of the 229.

We would propose that the Department generate its list on a monthly basis beginning with January 1986, publish it in the Federal Register and provide affected companies with an opportunity to comment on any potential errors.

2. Enforcing the Sanction

Proponents of the chaos theory maintain that even if the Department can ascertain who is in violation of Section 3, it will be unable to police the enforcement of Section 3. They paint a picture of bureaucrats poring over thousands of leases trying to determine whether or not the applicant for a lease is a subsidiary or division of a company covered by Section 3.

If the Department were stupid enough to adopt this approach chaos might well result. But any responsible manager would soon realize that Section 3 can be made largely self-enforcing. The key to doing this is keeping a current list of Section 3 violators and making use of the lease agreement.

The Department merely has to publish a monthly list of companies in violation of Section 3. Then, it need only require that the recipient of any MLA lease sign, as a part of the lease agreement itself and under penalty of perjury, a statement that it is not in violation of Section 3, nor is it an affiliate, subsidiary or under common control with any company listed as being in violation of Section 3 during the month in which the lease was signed. The lease agreement could also indicate that an untruthful answer to the qualifications statement would render the lease void and that subsequent purchasers of the lease would have no greater right than the original lessee.

This approach should greatly ease any administrative burden on the Department. Further impetus to compliance can be supplied by losing bidders or applicants for mineral leases who will closely scrutinize the Section 3 status of those who receive leases.

As this discussion makes clear, the Department has the tools, the information and the powers to make enforcement and implementation of Section 3 relatively efficient and painless. There need be no chaos unless the Department deliberately sets out to sabotage its legal responsibilities.

3. Impacts on Competition

Opponents of Section 3 also maintain that enforcement of the law as currently written will have a devastating impact on competition for Federal mineral leases. Again, this argument does not hold up under analysis.

To believe that Section 3 will have a major impact on competition for oil and gas leases, one would have to believe that the Exxons, Mobils and Chevrons of the world will get out of the oil business in order to hold onto a handful of non-producing coal leases. This position scarcely deserves comment. In fact, the major oil companies have made it clear beyond the shadow of a doubt that, if Section 3 remains in effect, they will divest themselves of non-complying leases with alacrity.

Because the impacts of Section 3 may be less stringent on companies which are only in the coal business , a variant of the competition argument holds that these companies will choose to keep their old coal leases, rather than bidding for more expensive new leases, and that this will seriously diminish competition for new coal leases and lessen the return to the public from new leasing. The same lack of competition for coal leases would also occur, it is alleged, were the Section 3 prohibition limited only to coal leases. This argument, which is used to support the so-called "turnback" option, deserves some scrutiny.

Let us begin by noting, as did the Linowes Commission, the structural factors which diminish the potential for competition in the coal industry. Most coal leases are either maintenance or bypass tracts with only one potential bidder regardless of Section 3. Unlike the oil and gas industries where unitization allows an outsider to bid on any small portion of a field and benefit from its overall development and where transportation costs are relatively unimportant in determining commercial viability, a coal lessee must be able to assemble a mineable tract close to transportation.

So it is important to begin by realizing that there will be relatively little competition whether or not Section 3 is amended.

The theoretical impacts on competition are lessened further when we examine the past behavior of those companies likely to be affected by a coal-only Section 3. Our analysis reveals that companies holding the preponderance of undeveloped leases have been conspicuous by their absence from competitive leasing in the last decade. Many of the largest holders have never bid on a single post-FCLAA lease.

In summary, it is obvious that Section 3 will have no impact on future competition for oil and gas leases. The impact on future competition for coal leases also appears much less than prophecized. And it is conceivable that some companies who relinquish non-producing old leases may re-enter the competitive leasing market to add new reserves, thereby increasing competition.

4. Emergency, Bypass and Preference Leases

In his testimony before the Subcommittee, Assistant

Secretary Griles indicated that violation of Section 3 could prevent coal operators from receiving emergency, production maintenance or preference right leases. This is clearly true. The question is whether any unacceptable consequences flow from these occurrences. Let us take PRLA's first. Since its inception in 1920, the prospecting provision of the Mineral Leasing Act has not provided an absolute right to a lease. PRLA applicants could be denied leases if they already held too much acreage, were citizens of non-reciprocating nations or otherwise unqualified. The PRLA holder has a series of options: he can dispose of his non-diligent old leases, he can sell his PRLA to someone who qualifies or he can decide to forego the privilege of receiving his PRLA in order to hold onto his old leases. Presumably any applicant caught in such a situation will make whatever decision is in his best interest.

The loss of access to bypass leases strikes us as rather unimportant. The loss of a hundred acres of coal should have little impact on either a major Western coal mine or the Federal treasury. It is quite possible that, in some cases, a mining operation would rather reap the revenues from near-term mining, rather than waiting to develop an old leases. If so, it will divest itself of its noncomplying leases.

The most serious issue raised by Mr. Griles was the possibility that an operating mine might be forced to shut down, with a loss of jobs, for want of a production maintenance lease. We find it almost inconceivable that anyone would shut down a mine in which tens of millions of dollars had been invested and for which coal contracts exist (else why would more reserves be needed) to hold onto leases which have defied development for at least fifteen years. We have never heard even a single possible example of this raised.

But assume that such a situation were plausible. This case would only arise in a circumstance where a lessee's old leases, acquired for a song, had a present value in the tens of millions of dollars or more. The existance of even a single instance of such windfall profits from speculative holding would call for more stringent, rather than less severe, action by Congress. However, we think that merely to recite the fact situation which would need occur to bring about this eventuality shows its remote probability.

5. Pending Actions

Finally, Mr. Griles raised the prospect that the Section 3 prohibition might be unfairly visited on a firm with a pending LMU application that would, presumably, eliminate a problem with a non-producing lease. If this is such a worry, we wonder why the Department has waited so long to issue its LMU Guidelines? Nor are we aware of a flood of LMU applications.

Again, simple management steps are available to minimize this risk. One would assume that affected lessees will quickly make their LMU applications. The Department could establish priorities in processing LMU's to deal with these problem cases first.

Why Apply Section 3 to Oil and Gas Leases ?

One of the most commonly asked questions about Section 3 is why it should prohibit the future issuance of oil and gas leases. Companies in the oil and gas business, particularly those who have only recently acquired coal subsidiaries, often raise this point. They assert that it is either unfair or inappropriate to apply Section 3 to oil and gas leasing.

The application to oil and gas leases makes sense only when the goals of Section 3 are fully understood. Congress sought a way to apply the greatest lawful pressure to force production or relinquishment of non-complying leases. It recognized that a coal-only provision would have far less impact and purposely chose a more potent alternative.

Many of the oil and gas companies project an air of being surprised and unwitting victims of Section 3. This is rather difficult to believe unless one assumes that they purchased coal companies and their assets without an examination. Section 3 has been on the books for nearly a decade. For much of that period, applicable regulations would have required termination or cancellation of these leases in 1986.

The complaints about the impact of Section 3 on oil and gas operations also ignore the ease with which companies can avoid the impact of Section 3. They have merely to sell or relinquish these leases and Section 3 will no longer apply.

Why Turnback of Old Leases is Unacceptable

One proposal for amending Section 3 would allow a company holding non-complying leases to receive a new coal lease by "turning back" noncomplying leases containing an equal amount of coal. We are strongly opposed to this proposal which seems written to reward the most flagrant violators of Section 3.

The proposal is riddled with flaws. First, it requires a limitation of the Section 3 prohibition to coal leases only. But even were Congress to decide, as a policy matter, that such a change were warranted, the turnback would still be inappropriate.

The reason for this is that the turnback totally compromises the Section 3 goal of forcing development or relinquishment of non-producing leases. Instead, the holder of old leases can simply hold them without any penalty.

Furthermore, the turnback, if anything, gives an advantage to those who hold the most noncomplying leases. The holder of thirty noncomplying leases who wishes a new coal lease can search among that vast store and pick out the worst leases -- the "cats and dogs" -- and turn them in. The holder of one or two noncomplying leases would have far less leeway.

The fact that turnbacks are on a ton per ton basis exacerbates this tendency. Again, nearly worthless old leases could be turned in for the right to acquire extremely valuable new leases.

It is apparent that the turnback has been fashioned to meet the needs of that small band of coal leasing "scofflaws" who hold so much noncomplying acreage that even the most minimal rental would be too costly. It is not clear why Federal mineral leasing policy should be gutted in order to benefit five or six companies who have been holding cheaply acquired leases with little prospect of development.

Why Won't Section 7 Provide Adequate Incentives to Diligence

Some commentators have suggested that the Section 7 diligence provision in some way renders Section 3 superfluous. The argument is that undeveloped leases will be terminated by action of Section 7 almost as soon as they would be terminated by Section 3.

Our research indicates that this assertion is flatly wrong. Section 3 applies to leases which have been held continuously for ten years on August 4, 1986. Section 7 applies ten years after readjustment. Most pre-FCLAA leases will be readjusted during this decade (207 were scheduled for readjustment before April 1, 1985, the remaining 311 will be readjusted between April 1, 1985 and 1995; the mean readjustment year is 1987 which makes the mean Section 7 dealine 1997). Thus for nonproducing leases which have not been assigned, Section 3 impacts -- on the average -- eleven years earlier.

Obviously, many pre-FCLAA leases have been assigned at least once and would not be subject to Section 3 on August 4, 1986, so they would not be affected for at least ten years after the assignment. We have analyzed 203 pre-FCLAA leases which have been subject to post-FCLAA assignment. Eiighty percent of these leases would still be affected by Section 3 before Section 7.

Finally, the impact of Section 7 may be dramatically postponed for those leases which the Department has failed to properly readjust. If, as the Department maintains, these leases could not be revised in accord with FCLAA, then the existing Section 7 regulations will not apply to them until after the next readjustment. And because their most recent readjustment was not pursuant to FCLAA, these leases can not be readjusted until a twenty year term ends and Section 7 would not take effect for thirty years -- fifty years after initial issuance of the lease.

In summary, Section 3 is not duplicative of Section 7. While it may not cause the termination of all nonproducing leases (a lessee who wishes no further Federal mineral leases can disregard it or assignment can toll the ten year period), it will impact many, if not most, nonproducing coal leases far in advance of Section 7.

II. Changes in Section 7 Diligence

Although changes in Section 3 have gotten the most attention, there has been a significant amount of agitation for changes in Section 7, which provides that all post-FCLAA leases must be producing in commercial quantities within 10 years of lease issuance or be terminated. Pre-FCLAA leases are terminated if not producing in commercial quantities within ten years of the first post-FCLAA lease adjustment.

We are not convinced that any changes in Section 7 are warranted, but we retain an open mind on the subject. It is unfortunate that a legitimate debate over Section 7 is being entangled with the controversy over Section 3. We remain somewhat skeptical over claims that mines can not be developed within the ten year time frame. The experience in the Powder River Basin areas of Montana and Wyoming indicates that major mines can be permitted and built in far less time than that.

However, we are willing to analyze arguments that changes in Section 7 can be made which retain the policy of encouraging diligent development while providing some added flexibility for operators who are developing a mine. We do not believe that any proposal we have yet seen is acceptable, nor do we have any particular proposal in mind. We do, however, feel that any amendment to Section 7 must comply with the following principles.

(1) It can not apply to pre-FCLAA leases. Each pre-FCLAA lease is already given 30 years from issuance before the Section 7

termination applies. We can see absolutely no justification for providing any additional relief for these leases.

(2) It can not apply to any Preference Right Leases. Preference Right Leases are issued noncompetitively without bonus payments to applicants who demonstrate that they have discovered coal in commercial quantities. To make the commercial quantity showing, the applicant must show that he can mine and sell his coal. If a PRLA applicant were to have stated that he could not develop his lease within 10 years, he would not have been granted the noncompetitive lease. Therefore, applying any extension or relaxation of Section 7 to a preference right lease would extend a right which, in retrospect, should have never been granted.

(3) It must deal with the increased value problem for leases issued between 1977 and the present. A longer or more flexible diligence period obviously adds to the fair market value of the lease. Presumably that additional value will be reflected in the bids and fair market value determination for leases issued after any change to Section 7 is made. But a problem arises when extending the Section 7 period for already issued leases (clearly this problem would be even greater with respect to pre-FCLAA leases if principle #1 was not observed). Bids were made and fair market value was determined for these leases based on the presumption that these leases would be terminated in ten years if not developed.

As the Linowes Commission noted, unilateral extension of the diligence period confers a benefit on those who bought leases with a ten year diligence period. This problem is not obviated by proposals which require payments for diligence extension. If the same payments are required for new leases with a higher fair market value and older leases initial issued at something of a discount, the inequity continues.

(4) The application to bypass and production maintence leases. Many of the post-FCLAA leases were "maintenance" and "bypass" leases. These leases were, for all practical purposes, drawn to the specifications of the holders of existing leases to enable continued production. Often the tract delineation process effectively excluded competition for valuable coal deposits and occassionally a different valuation approach -- the so-called "Josephs" split -- was applied which lowered bonus payments by half. Therefore we think that any proposal for change in Section 7 should be developed in light of consideration of this issue.

(5) The proposal should not discourage production. An anomaly in most current Section 7 revision proposals we have seen results in the following situation: an operator who meets Section 7 diligence and then falls before the one per cent per year continuous operation requirement will face a far stiffer economic penalty than an operator who never even attempts to met the ten year diligence requirment.

The operator who originally met diligence will pay as much for one year of non-production as the operator who did not does in four years and as much in two years as the latter would pay in six. This is because the penalty for failing to meet continuous operation is based on the royalty which would have been paid if one per cent had been mined while the diligence extension payments are based on a sliding scale that begins at one-tenth that amount.

These principles are not absolute, but they provide an approach to Section 7 which may allow concensus.

III. Comments on Proposals to Reduce Royalty Rates On Leases Issued Before 1976

Pursuant to Section 35 of the Mineral Leasing Act, federal coal royalty payments are divided equally between the Federal government and the State in which the lease is located. For leases issued after the passage of FCLAA, the statutory royalty rate is 12 - 1/2% for surface mined coal. By regulation, underground mines pay an 8% royalty.

The FCLAA royalty provision was a response to the royalty rates which had been established by BLM during the 1960's. The BLM royalty -- most commonly a flat $0.15 per ton -- generally yielded less than one percent of the value of the mined coal to the public. Congress viewed this, quite rightly, as a pittance and rejected both Departmental and Presidential requests for authority to set lower rates. President Ford's veto of FCLAA specifically mentioned the royalty rate as a major concern. The veto was overridden by bipartisan votes in both chambers.

As with so many other provisions of FCLAA, the statutory royalty applies to pre-FCLAA leases only after readjustment. In testimony before the House Interior Committee some holders of old leases and utility companies purchasing coal from them advanced the proposition that applying this royalty rate to them was, somehow, unfair. They further raised the specter that application of these royalties to "old" leases would somehow create a significant rate shock for electric consumers. Both of these contentions are, as will be shown below, groundless.

To our immense surprise, the House Subcommittee -- which contains no members from Western coal producing states -- addressed this issue without receiving any testimony from representatives of affected states or OMB. The proposal they enacted would have the effect of depriving Federal and State treasuries of nearly $1 billion between now and 1991. Half of that would be revenue destined for the Federal treasury, half would be revenue owed to the States of Colorado, Montana, New Mexico, North Dakota, Utah and Wyoming. It is inconceivable to us that, at a time of record budget deficits in Washington and increased pressures on States to provide services, any such proposal could be given serious attention.

Why would this proposal be so costly? Because it would lower royalties for the leases that will be producing almost all of the Federal coal that is mined during that period. Most of the leases which have been issued since the passage of FCLAA at the statutory royalty will be just coming into production at the tail end of that period.

The Office of Technology Assessment Assessment of Development and Production Potential of Federal Coal Leases estimated that "assuming timely readjustment of leases to a minimum of 12.5 percent for surface and 8 percent for underground coal" royalties would range from approximately $200 million in 1986 to $500 million in 1991. Over that period, total royalties would be in excess of $2.2 billion.

A phased in royalty proposal, like that proposed in the House, would slash these revenues, most deeply in the early years. Thus in the first year after readjustment, rather than paying 12 - 1/2% a lease would pay at the 1976 rate. In an area like the Powder River basin, the 1976 rate is approximately 10% of the statutory royalty. In Utah (even with the lower underground royalty), it is approximately 7%, In New Mexico 8.5%, in Western Colorado, 6%. [Reference coal prices are taken from the FEISS, Appendix 4] In other word, almost 90% of proposed revenues would be cut. In the second year, the effect would be reduced by approximately ten per cent as the royalty was increased by that amount, and so on.

In fact, because of the retroactive effect of the House language which would reinstate a lower royalty for lessee who had previously been readjusted to 12 - 1/2%, there might be an even sharper early drop for lessees who might pay nothing for a year or more in order to recoup amounts previously paid.

The impacts of this loss of revenue would be significant. The loss to the Federal government would be approximately one half billion dollars. The six State governments would lose the same amount. Wyoming would be the biggest loser followed by Utah, Colorado, Montana, New Mexico and North Dakota.

These revenue losses would be particularly hard on the areas most severely effected by the impacts of coal development. Each of the Federal coal states has established a program for distributing its Federal mineral revenues, generally large portions go for schools, highways and loans to impacted communities.

The fiscal impact of proposed royalty reductions is, by itself, a compelling reason to oppose any such proposal. But even were the State and Federal treasuries swollen, there is almost no merit to the arguments put forward by those seeking this windfall.

Let us first examine the unfairness argument. At its core, the argument seems to be that having gotten away with highway robbery for twenty years because of the originally low royalty rates, it is now unfair to charge them a fair rental. There is nothing inherently unfair about the 12 - 1/2% rate. Not only is it charged to all new lessees, but it seems to be charged by most private Western coal lessor, such as railroads. Nor is the implementation of the rate sudden or surprising: the law has been on the books for nearly a decade.

Whether dealing with coal leases, assigned mortgages or real property, it is fairly standard business practice to expect to be charged the market rate when an old contract expires or is readjusted. There is nothing to suggest that this group of lessee -- who did after all receive their leases at very little cost and have had twenty years to profit from the old fixed royalties at a time when inflation and the energy crisis drove coal prices up severalfold -- should escape the normal practice.

In the rare instance where imposition of a 12 -1/2% (8% underground) royalty might make a mine unprofitable, an adequate remedy is provided by the royalty reduction process, 43 CFR 3485.2(c).

The rate shock argument is equally specious. In their House testimony, the proponent's continually referred to royalty increases of 1500%, perhaps hoping to leave the impression that these immense increases would lead to similar electric rate increases. This is pure hogwash. Even a utility foolish enough to sign a total passthrough agreement (in which it agreed to pay the coal company the amount of any royalty required to be paid) is facing no more than a ten percent increase in its coal cost. Often given the ownership interlinks between Western utilities and coal mining subsidiaries, this simply means that the regulated arm of a company is transferring funds to the unregulated. The majority of coal companies, which were unable to locate such accomadating (indeed, foolhardy) purchasers, might see their margins reduced somewhat.

And even a ten percent increase in the price of coal would not lead to a ten percent increase in utility bills. According to statistics compiled by the American Gas Association, the delivered price of coal, including transportation and cleaning normally accounts for less than 35% of the charge to the utility ratepayer. The minemouth cost of the coal is less than half of that. And it is rare that coal from a single mine will account for all of fuel in a utility system.

Our own estimates, based on a review of several Western utility systems, are that the effect of implementing the 12 - 1/2% royalty on time will have less than a one percent impact on rates. It is noteworthy that the utilities leading the charge on this issue have signed contracts for extraordinarily expensive coal, among the most lucrative coal contracts in the West. While we have no doubt that the fervently desire lower royalty rates, we also have well founded suspicions that some of the fuss they are making over the "federal royalty burden" is designed to direct attention away from inquiry into the prudency of the underlying coal contract, with or without 12 - 1/2% royalties.

IV. Comments on Proposals to Amend the Prohibition on Railroad Ownership of Coal Leases.

On October 17, the Chairman of the Full Committee introduced two amendments to Section 2(c) of the Mineral Leasing Act which prohibits the ownership or acquisition of Federal coal leases by common carrier railroads and their affiliates. One amendment would repeal Section 2(c), the second would establish a conditions under which railroad companies could lease up to 23,040 acres of Federal coal. WORC has testified on this issues several times in the past, most recently in opposition to S. 1542 during the Ninety-Seventh Congress. We have consistently opposed the efforts of the Burlington Northern, Union Pacific and Santa Fe railroads and their affiliates to lease and develop Federal coal.

We are not at all convinced that railroad leasing will not have anti-competitive impacts. The railroads consistently quote the 1980 Department of Justice study Competition in the Coal Industry to argue that there will be no anti-competitive impacts. We have never been particularly impressed by the basic analysis in that document, which placed extraordinary reliance on an inflexible threshold test based on the ratio between railroad coal reserves and total reserves, rather than the relationship between railroad coal reserves and the prospective market. To our mind, it is rather irrelevant that a railroad has less than 15% of the total reserves in an area, if its reserves are adequate to meet 100% of demand in that area. The 15% threshold test used by the Justice Department was not developed in the context of natural resources where reserves generally are hundreds of times of any demand, it was developed to be used to assess the potential anti-competitive impacts in an industrial context where it was determined that any company with production in excess of 15% of demand could pose a threat to competition. Clearly, if railroads were allowed to lease the Federal "checkerboard" portions adjacent to their own massive reserves, they would have the potential to exceed the 15% threshold in almost every coal region.

Those who place reliance on the Justice Department report also conveniently overlook the fact that it said the following about the impacts of repealing Section 2(c) on the Burlington Northern:

> The company was found to have market power, and it was found to be able to restrict the output of transportation services by failing to increase the capacity of its rail network ... it seems possible that leasing coal to the Burlington Northern would have an anti-competitive effect.

Our concerns over railroad leasing go beyond the competition issue. At the very time the land grant railroads seek the ability to get into coal production -- and each of them has established a holding company with a coal holding and mining subsidiary -- they continue to abandon hundreds of miles of spur and branch lines serving agricultural communities. This is particularly true of the Burlington Northern.

Section 3 of the Northern Pacific Land Grant statute, which is the source of Burlington's coal lands, states in part that the lands granted to the railroad and its successors by Congress was granted "for the purpose of aiding the construction of said railroad and telegraph line to the Pacific Coast ..." The other railroad grant statutes contain similar language. We wonder whether the encouragement to plunge into the coal mining business that repeal of Section 2(c) might offer will further diminish the companies ability and willingness to meet the needs of non-coal shippers in its service area.

Along these lines, we renew our request made in the 1981 hearings that any action by Congress on Section 2(c) take place in the context of an examination of measures to insure that revenues derived from railroad grants continue to be applied to their original purpose: the development and maintenance of a viable railroad transportation system. The three land grant railroads have each established holding companies, the railroad has become a subsidiary of the holding company and the valuable coal lands originally owned by the railroads have been transferred -- for little consideration -- the separate natural resource subsidiaries. This makes it possible for the holding company to derive high returns from the natural resource subsidiary while, at the same time, arguing that the railroad subsidiary does not have adequate revenue to maintain certain types of services.

These issues, along with the question of whether or not the transfer of the grant lands was itself lawful, all deserve extended consideration. We do not believe that any purpose is served by severing one portion of the issue and legislating on it in a hasty fashion, particularly on a bill which is really concerned with coal leasing diligence.

The second amendment proposed by the Chairman is styled as a "compromise" because it does not directly repeal Section 2(c) and it places certain limitations on a railroad's ability to obtain a lease. On analysis, however, the "limitations" appear to be rather insubstantial. The acreage limitation allows the railroads to lease as much as is prudent. The exceptions to the cooperative leasing requirement would cover most real-world situations.

While the "compromise" amendment may be preferable to outright repeal, it has little else to recommend it.

V. • Comments on Proposed Legislation

A. Comments on S. 372

It should be evident from the preceding sections of this Statement that we are in fundamental disagreement with the main provisions of S. 373. A brief discussion of the more critical points follows:

Page 2, Line 6 - The limitation of Section 3 to "leases to coal deposits" is unacceptable because it removes the coverage of other Federal mineral leases.

Page 2, Line 11 -- The limitation of Section 3 to pre-FCLAA leases guts the role that Section 3 plays in "backstopping" Section 7. Because Section 7 has yet to be applied, it is not clear how easily and quickly it can be implemented in the face of administrative and judicial challenges. Because the Section 3 prohibition is essentially self-executing (no violator could sue to require the Secretary to grant a lease), it might be applicable at a time when efforts to terminate a non-producing lease are being stymied.

Page 2, Line 18 - Page 3, Line 2 -- The "turnback" provision of S. 372 allows a Section 3 violator to hold onto all but one of his noncomplying leases while garnering new leases. Our opposition to this is detailed above. Unlike other versions of the turnback which have been proposed, S. 372 allows the noncomplying lessee to use the turnback again and again.

Page 3, Line 3 - Page 4, Line 4 -- The penalty rental provision for companies who hold one or two noncomplying leases suffers from several deficiencies. First, it applies a charge based on the lease being acquired, rather than the lease(s) being held. The additional rental is based on acreage, not tonage, and is only one-quarter of the currently inadequate minimum bid. Tracts in the Powder River Basin, where most new leasing is likely to occur, have a fair market value in excess of $1,000 per acre, so the rental will be so small as to not provide any incentive for relinquishment.

Page 4, Line 5 - Line 9 -- The turnback's reliance on ton for ton swaps, rather than value based swaps is rendered even more prone to abuse by the provision that such swaps will be "without regard to quality or location" validates the trading in of "cats and dogs" for higher quality coal.

Page 4, Lines 10-16 -- Implementation of any Section 3 penalty gives rise to problems with relinquishment. We recognize that it would be unfair to penalize a lessee for holding a lease which he is attempting to relinquish. However, requiring the Secretary to accept relinquishment creates major problems. The language of the current provision, for example, would allow relinquishment of an unreclaimed lease which had not been mined under a SMCRA permit, such as an old generally mined out lease which had not produced after SMCRA. We are also concerned by the use of the undefined term "significant disturbance". In addition, there may be cases where the Secretary would reject a relinquishment because other terms in the lease have not been complied with. Once the lease has been relinquished, it is unclear just what authority th3 Secretary would have to enforce those terms after relinquishment.

Rather than forcing the Secretary to accept relinquishment, the same result could be stating that Section 3 will not apply to a lease for which an irrevocable application to relinquish has been made for so long as the Secretary determines that the lessee is taking appropriate steps to discharge any remaining lease obligations. Obviously, once the obligations have been discharged, the Secretary can accept the relinquishment.

Pa~ 5, Line 1 - Page 8, Line 24 -- The proposed amendment to S n 7 does not meet the principles for Section 7 reform laid l out above. We note that this proposal would apply to pre-FCLAA leases and PRLA's. We believe that 20 years is to long before first production. In addition, the advance royalties for failure to ever attain diligent development are significantly lower than those associated with failure to meet continued operation.

The language in lines 3-9 on page 5 would seem to allow for a significant lowering of the royalty rate currently charged by allowing adjustments to the flat 12.5% royalty. Given the potential impact that this might have on both Federal and State revenues from Federal royalties, we do not believe that such a proposal is warranted.

Page 7, Lines 13-16 -- This provision would allow payment of the insufficient advanced royalties created by this proposal to serve as compliance with Section 3. Given the fact that Section 3 is only applied when a violator seeks a new Federal lease, this provision would allow a leaseholder to pay advanced royalties only in the year when such a new lease is sought. Presumably, this provision would only be used when a leaseholder felt that paying the advanced royalty was less onerous than using either a turnback or rental payment.

Page 9, Lines 1-7 -- We do not have any significant objection to modifying the current timetable for submission of an operation and reclamation plan. We are somewhat concerned that no minimum "lead time" prior to the disturbance is specified.

Page 9, Lines 13-15 -- The definition of "commercial quantities" is currently the subject of litigation. We would oppose this statutory definition. Our review of producing mines indicates to us that 1% is far lower than customary production from operating mines.

Page 10, Lines 12-18 -- We have major reservations about negotiated sales. As former Deputy Undersecretary Quarles pointed out in testimony before the Linowes Commission, nothing in the history of the program or the background of the Department personnel indicates that they will be able to handle negotiations without the prospect of irregularity. Although this provision speaks of an "experimental" program, it places no limitations on the use of this experimental practice. Given the preponderance of bypass and maintenance leases in the Federal coal program, this experimental program could eventually swallow up the rest of the program.

Page 10, Lines 19 -Page 11, Line -6 -- This provision, which on its face appears to be geared to achieve a desired result, is fraught with serious consequnces. First, it would make it illegal to ever return to the old fair market value sales method used successfully by the Department in the early 1980's lease sales and practically mandate the use of the sales method used in the scandal-ridden Powder River Basin. [Under the old method, the government published it estimate of fair market value and accepted no bids below that published amount. Under the "new" policy, the government accepts all bids above an arbitrarily established "entry level bid" and can use bids below its initial estimate of fair market value to adjust downward its estimate of fair market value.]

A more serious flaw is that the proposed language would extend the prohibition after bids have been accepted and evaluated and even after a lease has been granted. This would apparently insulate the Department from inquiries into whether or not it has met its statutory responsibility to obtain fair market value. It might make it impossible to challenge another "fire sale". It might even prevent investigations like those of the House Appropriations Committee, the General Accounting Office or the Linowes Commission.

This provision may be the result of a simple misconception or its sponsors of its effects or it may be part of a hidden agenda being put forward by mid-level bureaucrats of the Department who have taken a series of recent actions to curtail public scrutiny of the coal program [These actions include the recent proposed regulations to hold "secret auctions" for coal leases and the recent refusal to provide previously available production and royalty collection data.] Furthermore, this proposal effects a significant amendment to the Freedom of Information Act.

We can not emphacize strongly enough our opposition to this provision in its present form.

B. Comments on S. 570

We have also reviewed S. 570. A repeal of Section 3 is not justified and we doubt it will find little support. The provisions of S. 570 relating to amending Section 7 are similar to those of S. 372 as are the proposals for experimental negotiated sales and delaying the submission of the operation and reclamation report and our views are set forth above.

There are three other provisions of S. 570 which deserve specific comment. First is the provision in Section 3 to remove the contiguity requirement for establishing logical mining units. This proposal has significant potential for abuse. We believe that the logical mining unit concept should only apply to a mine, that is a series of contiguous leases. We do not believe that non-contiguous leases should be treated as if they were part of a single mine.

In the Gillette area of Wyoming, a pattern has arisen in which coal companies attempt to develop "double mines" -- two geographically distinct operations, production from either of which can be used to meet supply contracts. This provision would allow an operator to "shelter" a totally non-producing mine or lease block under the production of an operating mine on the grounds that the two geographically separate units are operated as a single operation.

This proposal tilts the playing field in favor of large leaseholders who would be given opportunities to evade diligence which are denied those who run single mines. The tilt in this proposal would be exaccerbated by the companion provion in Section 5 to delete the forty year mine out provision of the current LMU rules.

C. Comments on S. 976

The issue raised by S. 976 -- whether access to Federal coal leases should be denied to a company which is importing coal from a foreign operation -- is one which is relatively removed from the concerns of WORC and its members. It also raises questions raising international trading policy which are rather complex.

However, the fact situation which gives rise to this legislative proposal underscores a point which we have attempted to make many times in the past: Federal Western coal is not the only source of reserves to meet America's energy needs. All to often, the Federal coal management and leasing program seems to have been driven by a belief that almost all coal needs must be met by leasing Federal coal. This overlooks the abundance of non-Federal Western coal and of Eastern coal to meet many energy needs. Also, the coal program has often overlooked the potential that dumping enormous amounts of Federal coal on the market for a song has on the exisitng coal producing infrastructure in this country. Sometimes, such giveaways are justified as devices for lowering the ultimate cost of electricity to consumers. Unfortunately, there are precious few hard facts to back up this view. Rather, the giving away of the public's coal seems to create a "reverse rent" which is vigorously fought over by leaseholders, transportation interests and utilities while consumer electric bills continue to rise.

D. Comments on Legislation Passed By the House Subcommittee Mining and the Environment, July 26, 1985

Section 2 of the Subcommittee Bill limits the prohibition on obtaining new leases to "competitive coal leases." This strips away the major clout of Section 3 -- its application to oil and gas leases.

As currently drafted, the new provision will not even apply to most coal leases. Preference right leases are removed from the scope of the prohibition. It is unclear why a lessee who has not developed existing leases should receive such a benefit. Section 2 also explicitly removes application of the prohibition from "emergency leases", thereby opening up a potential loophole. Furthermore, it is unclear whether or not the prohibition would apply to "leasing by application", currently defined in the Department's regulations (43 CFR 3425) as being distinct from competitive leasing. Leasing by application occurs wherever there is not an established Federal coal production region. Currently, this applies to Oklahoma and all Eastern States. The Department is considering a proposal by its Western State Directors to de-establish the San Juan and Fort Union regions. In other words, only new "non-emergency" leases in Wyoming, Colorado and Utah would be subject to Section 3.

Section 2 of the Subcommittee Bill also appears to make significant changes in the reach of Section 3, as it was previously established by Sections 3 and 11 of FCLAA. The current statutory language prohibiting leases to an "person associate, corporation or an subsidiary, affiliate, or person controlled by or under common control with any such person, association or corporation" has been replaced by the far narrower "person, association, corporation, or to any affiliate thereof (as defined by Section 43)" which opens the probability of evasion through corporate reshuffling.

The New Section 43

The new Section 43 found in the Subcommittee Bill has little to recommend it. We note at the very beginning, it retains the "turnback" mechanism.

We have spelled out our strong opposition to the turnback and see little reason to repeat those points here. We do not believe that the use of "value factors" addresses any of those problems. In fact, as set forth in the bill, the regional average value factors seem perversely designed to allow lessees to turn in the least value coal -- based on development potential and profitability -- in return for the most valuable coal.

We have serious concerns about the provisions of section 43(b)(D)3(A) which seems to allow a lessee to relinquish a lease on which some surface disturbance has occurred.

The alternate method for evading Section 3 set forth in Section 43(a)(2) is also flawed. One major problem, given the impact that past assignments have on delaying the effect of Section 3, because the ten year clock is tolled by an arms-length assignment, is the language that states that "after the first new competitive coal lease is issued to any ineligible lessee who qualifies pursuant to paragraph (2), the ineligible lessee is also qualified for later new leases, and the lessee shall no longer be treated as an ineligible lessee." The next sentence removes that protection where the lessee "acquires" an additional noncomplying lease.

This creates the following possibility. Lessee A meets the requirements of paragraph (2) in 1986. In 1988, a lease which he acquired by assignment in 1978 has now been held without development for ten years, but he may acquire further new leases without either relinquishment or meeting paragraph (2) because that lease was not acquired after the first determination. It was acquired ten years before, it became noncomplying in 1988.

Beyond this, we have difficulties with both the qualifying payment and significant expenditure criteria set forth in the Subcommittee Bill.

The significant expenditure criteria , as currently set forth, is somewhat deficient though we believe that its flaws are easily remedied. We do not believe that Section 3 should apply to a lease where tens of millions of dollars have been developing a mine and where development is likely. However, the language now found in Section 43(d) is not specific enough. Witnesses before the Subcommittee who have requested this kind of treatment have spoken of expenditures of tens of millions of dollars which might be put at risk through a Draconian interpretation of Section 3. In light of this testimony, we believe that a specific dollar minimum should be set to guard against abuse.

The concept of qualifying payments raises conceptual and concrete difficulties. The proposal in the Subcommittee Bill suffers from at least two major deficiencies:

(1) It delays the payments until the issuance of the new lease, rather than requiring payments beginning on August 4, 1986;

(2) The amounts suggested seem extremely low when compared to costs which a company would be required to make to obtain new reserves or when compared with the far higher penalty faced by an operating mine which must make payments in lieu of continuous operation pursuant to Section 7.

A final problem with the new Section 43 is found in its definition section. We have already commented on the narrow definition of affiliate. The definition in Section 43(e)(3) of "noncomplying coal lease" limits application of Section 3 to leases issued before August 4, 1976. In light of the Department's previous inability to enforce diligence, we see no justification for doing this. If, in fact, the Department is successful, the old definition creates no problems because leases will be terminated before they can be subject to penalty. If the Department continues its current track record, application of Section 3 to post-1976 leases is critically important.

Logical Mining Units

Section 3 of the Subcommittee Bill makes major changes to the concept of logical mining unit established in FCLAA. Subparagraph (a) removes the contiguity requirement now found in the law. We are in sympathy with an amendment which might solve the problem faced by a handful of mines where a narrow strip of land separates parts of what would otherwise be a single tract. The proposed language seems too broad to us, especially when taken in conjunction with the next paragraph. Our concern is that this provision might be applied in the Powder River Basin area where some companies have two large mines, often covered by the same coal contracts, some miles from each other. Application of this provision to those mines might give them a competitive advantage over other mines.

We are not aware of any testimony justifying repeal of the forty year mineout provision and see no reason to change it.

Amendments to Section 7

The Subcommittee Bill contains a series of major changes to Section 7. In some areas, existing language seems to have been changed with little reason, creating the possibility of confusion. For example, the current language states "A coal lease shall be for a term twenty years and for so long thereafter as coal is produced annually in commercial quantities from the lease," while the Subcommittee Bill states "A coal lease issued shall be for a term of 20 years and for so long thereafter as the condition of continuous operation is met." Barring some explanation of why the new language is preferable, we believe that current language should be used.

A similar language difference, which might actually mask a significant change is found in Section 6(b) where excuses from the condition of continuous operation are described as follows: "In computation any time during which development is interrupted by strikes, the elements, casualties, or other causes not attributable to the lessee shall be excluded." This would replace the following language "Each lease shall be subject to the conditions of diligent development and continuous operation of the mine or mines, except where operations under the lease are interrupted by strikes, the elements, or casualties not attributable to the elements." The difference between "causes" and "casualties" may be significant. It might allow a lessee who had not secured a contract to say it was due to "cause not attributable" or it might allow general economic conditions to be used. It is difficult to escape the view that this change was inserted by the drafters as a subtle way of gutting almost any effect that the continuous operation requirement might have.

The Subcommittee Bill contains a new Section 7(b), "Payments in Lieu of Diligent Development." We have indicated in our testimony that we view extensions of the diligence period for post-1976 leases, which were issued for fair market value and with a minimum 12.5% royalty, as as presenting fewer problems than the allowance of such payments for pre-FCLAA leases. However, the scheme set forth in Section 7(b) is unacceptable in at least three respects.

(1) The payments called for are far too low. Again, we note the irony that someone who develops a mine, starts production and then can not meet continuous operations faces a far stiffer penalty than someone who delays startup of production.

(2) It appears that the payments are recoupable. Recoupability not only drastically decreases the economic impact

of payment, it also encourages delay and uncertainty.

(3) The advance payments apply to leases issued subject to noncompetitive preference right applications. These leases were granted without any bonus payment to applicants who allegedly demonstrated that they had discovered coal in commercial quantities in areas where it had not previously been known. To make their "commercial quantities" showing applicants were required to demonstrate that they could feasibly produce coal in the near term. Failure to produce within the ten year term is a fairly strong indication that the commercial quantities application was either seriously in error or fraudulent. We see no reason to extend unwarranted subsidies in this case.

The Subcommittee Bill adds a totally new Section 7(f) effectively postponing the increase in royalties on pre-1976 leases for ten years. This has evidently been put in at the instance of one Colorado utility which seems to have a rather improvident contract requiring that it buy very high priced coal with any additional royalty passed through.

Over 80% of the producing Federal coal leases were issued before 1976. They are currently paying an effective royalty of far less than 4%, but most of them are supposed to be subject to readjustment and the 12.5% royalty before 1989. State governments have already began to budget based on their 50% share of these royalties.

We are frankly stunned that the Subcommittee would consider adopting legislation that could have such a major impact on payments to the States without examining, in some detail, what those impacts would be and without requesting any input from the affected States. We believe that the Subcommittee should reject this particularly egregious case of special interest pleading.

Definitions

In 1982, James Watt changed, with almost no administrative record a series of definitions that had been adopted contemporaneously with the passage of FCLAA in 1976. These changes are the subject of several legal challenges. The Subcommittee Bill proposes to enshrine the Watt changes in legislation.

The proposed definition of commercial quantities is particularly upsetting. Had the Subcommittee taken the trouble to examine actual performance in the real world, it would have found that almost all operating Western mines far exceed production of 1% of reserves per year. Under these circumstances, we see little justification for enshrining that unrealistic figure in statute.

Conclusions

We do not believe that any significant change in Section 3 is called for. We can support provisions which would treat mines on which expenditures above some statutory minimum have been made as if they were in compliance. Similarly, we believe that the rigid contiguity requirement for logical mining units can be adjusted. But beyond this, we see no reason why those who have held lessees for such a lengthy period of time without development should be allowed to continue doing so.

As currently drafted this legislation is little more than a carefully calculated bailout for a handful of large coal companies who have consistently refused to develop Federal coal reserves they received at little cost. We see no reason for Congress to provide such a windfall.

November 4,1985

The Honorable Donald P. Hodel
Secretary of the Interior
Department of the Interior
Washington, DC 20240

Dear Secretary Hodel:

We are writing to call to your attention yet another instance of serious mismanagement in the administration of the Federal coal leasing program which threatens to deprive the public of hundreds millions of dollars of revenue and unjustly enrich a handful of favored coal lessees.

It has recently come to our attention that, notwithstanding clear statutory direction, field officials of the Bureau of Land Management and quasi-judicial employees of your office are failing to apply to readjusted Federal coal leases the 12 - 1/2% royalty (8 % for coal mined by underground methods) and ten year diligence period specifically required by the Federal Coal Leasing Amendments Act of 1976 (FCLAA) and the Department's regulations. Because of this, some leaseholders are reaping a windfall that may amount to millions of dollars per year on a single lease.

As you are well aware, Congress -- reacting to massive giveaways of public coal resources and the failure of the holders of such reserves to develop them -- established requirements in FCLAA that all new leases issued after 1976 contain mandatory provisions for a minimum 12 - 1/2% royalty and diligent development within ten years. After considering the matter, Congress decided not to immediately apply these two conditions to the more than 500 leases which had already been issued, but required that such terms would be applied to each and every "old" federal coal lease on its 20 year readjustment. Approximately 130 leases have been scheduled for readjustment since the passage of FCLAA.

The Department has used the alleged application of royalty and diligence terms on readjustment as one of its prime arguments for the repeal of Section 3 of FCLAA. It has argued that the application of diligence requirements on readjustment makes Section 3 redundant.

We had assumed that the process of readjustment was proceeding smoothly. However, as we began to analyze data made available to us earlier this year on the so-called "old" coal leases, we came across troubling discrepancies.

In response to a Freedom of Information Act request, the

Department made available approximately forty non-exempt elements of its Automated Coal Lease Data System. (Additional items, including royalty and coal quality data which had previously been made available to McGraw-Hill were denied us, making it difficult to estimate precisely the dollar cost of the improper readjustments.)*

Based on that rather incomplete data made available to us, it appears that BLM State offices have granted at least 22 lease readjustments at fifteen cents per ton -- approximately one-third to one-twentieth of the statutory royalty and significantly less than readjustment royalty the Department was using in the early 1970's ** Some of these leases were also renewed for a twenty year term rather than the ten year term required by FCLAA. An additional twenty-one leases had been improperly readjusted by the Interior Board of Land Appeals where, notwithstanding the announced position of the Department, IBLA was consistantly ordering that leases be renewed without the statutory minimum. *** Readjustment to the statutory terms had not been completed for as many as 70 additional leases which might be renewed on pre-FCLAA terms under some of the rulings handed down by IBLA.****

---

* Five of the improperly readjusted leases produced 2.88 million tons of coal in 1983. They paid a total royalty of $432,000. Had the statutory royalty been imposed, based on published selling prices for these leases, the total royalty would have been $5,183,7500. Thus, the loss to the Federal treasury was over $5 million dollars. The leases whose status we were not able to determine include 11 which produced 4.944 million tons in 1983.

** The following leases appear to have been improperly readjusted by BLM State Office according to information contained in ACLDS data made available to us: SL050862, E018804, S1062605, C012894,W075207, C037277, C079641, U07746, W055246, U020668, U38727, U46484, W038597, C011646, C0125457, C09005, W075206, W073289, W030052, U039706, U020641, NM065466. It is important to note that these State Office readjustments have occurred over the past 9 years, beginning at the end of 1976 and occurring as recently as January 1, 1985 for NM065466.

*** The Interior Board of Land Appeals has ordered post-FCLAA readjustments on pre-FCLAA terms in the following cases: Kaiser Steel, 63 IBLA 363; Franklin Real Estate 71 IBLA 13; Kaiser Steel, 76 IBLA 387; Pitkin Iron, 81 IBLA 81; Consolidation Coal Company, 87 IBLA 296. A number of additional cases are pending.

These cases involve twenty-one leases: SL069291, U02785, SL068754, U01215, SL048442-05115, SL071737, U025485, SL064903, SL058575, C07518, C07519, U017354, D056724, D047201, C012894, U039706, C020740, U073039, U073040, U073041.

**** We have identified 63 leases whose readjustment staus is unclear based on the ACLDS data. These leases are described in a letter to Acting Assistant Secretary Griles of this date.

There is litle apparent rhyme or reason to the pattern of errors. Sometimes leases issued in the same month twenty or forty years ago have been treated differently. Clearly, those leases which have been readjusted to comply with the law (as well as new leases) will face a siginficant competitive disadvantage vis-a-vis those leases which were not properly readjusted.

We would like to make it clear that we are not talking about "Rosebud" leases here. In the Rosebud case, Rosebud Coal Sales Company v Andrus, 667 F. 2d 949 (10 Cir.,1982) the Department attempted in 1977 to apply the FCLAA royalty to a lease which should have been readjusted in 1975, before FCLAA passed. The Court of Appeals ruled that the leaseholder had a right to have his leased renewed pursuant to the law which was in effect at the time the renewal should have taken place. All of the leases discussed above were slated for renewal after FCLAA and were governed by its terms.

Apparently, some of the renewals at the State Office levels were made by officials who misread Rosebud as applying to post-FCLAA renewals. Because the renewals were on terms favorable to the leaseholders, they, naturally, did not appeal. The only publicly available reports of the renewals, found in the annual Federal Coal Management Reports issued pursuant to Section 8 of FCLAA, made it appear that these renewals were pursuant to FCLAA.

The situation with IBLA is somewhat more complex. Beginning with its decision in Kaiser Steel 63 IBLA 363 (1982),IBLA has read Rosebud as establishing a principal that if the slightest procedural error were made in processing a lease readjustment, the applicant had an absolute right to a renewal on the previous terms, notwithstanding the passage of FCLAA. Because the previous administration had been grossly negligent in sending out notices of readjustments, IBLA's position threatens to shelter dozens of "old" leases from the equitable royalty and diligence obligations which the law imposes on them. IBLA's application of the principals of landlord-tenant relations to the federal property power is, to say the least, unprecedented.

The underlying premise of the IBLA position on this issue: that mistakes, negligence or even a willful failure to implement FCLAA by low-level BLM employees can have the effect of nullifying the law is unprecedented and flies in the face of over 100 years of precedent dealing with public land law in this country. As the United States Court of Appeals for the District of Columbia Circuit stated in the leading case on the subject:

> The government is too vast, its operations too varied and intricate, to put it at risk of losing that which it holds for the nation as a whole because of the oversight of a subordinate official. Montana Power Co. v Federal Power Commission 185 F. 2d 491,497 (D.C. Cir, 1950), see also Albrechtsen v Andrus, 570 F. 2d 906 (10th Cir. 1978), Utah Power & Light v. U.S., 243 US 383 (1917).

IBLA, of course, in neither an independent agency nor a judicial body; it is an administrative unit established by regulation with delegated powers to render a final Departmental decision on certain issues. It acts for the Secretary and can take no action which the Secretary could not take.

It is our view that the lease readjustments discussed above are void because they do not comply with FCLAA. Therefore, as Secretary, you have the responsibility and duty to address this problem. We recognize that much of the blame for the events which gave rise to this situation occurred in a previous administration; however, the solution to the problem is your responsibility:

> The Secretary is the guardian of the people of the United States over the public lands. The obligations of the oath of office oblige him to see that the law is carried out, and that none of the public domain is wasted or is disposed of to a party not entitled to it. Knight v United States Land Association, 142 U.S. 181 (1891)

Furthermore, there is no doubt that as Secretary of the Interior you have the power to remedy mistakes made by subordinates:

> the Secretary of Interior has broad plenary powers over the disposition of public lands ... He has a continuing jurisdiction with respect to those lands until a patent issues and he is not estopped by the principles of res judicata or the finality of administrative action from correcting or reversing an erroneous decision by his subordinates or predecessors in interest. ... So long as the legal title remains in the Government, the Secretary has the power and duty upon proper notice and hearing to determine whether the claim is valid ... Therefore, even though the BLM had determined Ideal's claim to be valid and the Assistant Secretary approved as final the determination, the Department had authority to reconsider its final decision. Ideal Basic Industries, Inc. v. Morton 542 F. 2d 1364, 1367-1368 (9th Cir. 1976) quoted in Utah International v. Andrus, 488 F. Supp 962,967 (D. Utah 1979).

To remedy this situation, we believe that you should take the following steps:

1. Determine how many leases whose readjustment date came after August 4, 1976 have been issued readjustments which do not contain the statutory royalty or a ten year term.

2. Remove all further jurisdiction from IBLA over lease readjustments and announce a final position applying the FCLAA lease terms to all leases readjusted after August 4, 1976.

3. Issue orders to BLM State offices that all lease readjustments will contain the minimum 12 - 1/2% royalty and ten year term, regardless of when lease notification was sent.

4. Notify leaseholders with improperly readjusted leases that you are exercising your powers to modify their leases to reflect the appropriate statutory terms. No injustice will be done to such leaseholders who have been on notice of the relevant statutory requirements since 1976.

We believe that the facts in this matter are established and unequivocable, but we would be happy to meet with officials of the Department to discuss the most efficient approach to remedying previous administrative errors.

For more than twenty years, the Federal coal program has been characterized by repeated instances of incompetence, inconsistency, failure to comply with the law, and failure to protect the public's stake in the value of its holdings. It is a complex and highly technical program, large portions of which are hidden from public view and scrutiny. Apparently, whenever the spotlight of attention is not focused on the program, the BLM bureaucracy thinks it can give away the store.

"Business as usual" must come to an end if the coal program is to get back on its feet. We look forward to seeing you take prompt and decisive action to correct this situation.

David Masselli
Washington Counsel
Western Organization of Resource Councils

Brooks Yeager
Washington Representative
Sierra Club

Geoff Webb
Washington Director
Friends of the Earth

DAVID CHARLES MASSELLI
ATTORNEY AT LAW
422 C STREET, N.E.
P.O. BOX 1814
WASHINGTON, D.C. 20013
(202) 546-6250

November 4, 1985

The Honorable J. Stephen Griles
Deputy Assistant Secretary
for Land and Minerals Management
Department of the Interior
Washington, DC 20240

Re: Readjustment Status of Federal Coal
Leases and Availability of Royalty
Collection Data

Dear Mr. Griles:

On April 1, 1985, the Department of the Interior, in response to a Freedom of Information Act Request by the Western Organization of Resource Councils ("WORC"), made available to WORC certain elements of its Automated Coal Lease Data System ("ACLDS).

In reviewing the data made available to us, it has become obvious that certain information relative to the readjustment status of various Federal coal leases is either missing or incomplete. We reviewed the readjustment status of approximately 220 coal leases which were scheduled for readjustment between August 4, 1976, the date of the passage of the Federal Coal Leasing Amendments Act (PL 94-377), and the present.

Our review indicated that approximately 125 coal leases were listed as having been adjusted pursuant to FCLAA to reflect a 12 - 1/2% royalty rate and a ten year lease term. It is fairly certain that an additional 43 leases, which are the subject of the attached letter to Secretary Hodel, were not readjusted pursuant to FCLAA. These leases were either (1) the subject of specific rulings of the Interior Board of Land Appeals, (2) were listed in the ACLDS data as having been readjusted on royalty terms inconsistant with FCLAA or (3) were not listed as having been readjusted and had a readjustment date prior to January, 1981, leading to the inference that they were continuing on prior terms.

In addition, we located 63 leases whose readjustment status could not be determined. All of these leases are past the readjustment date, all have apparently been sent notices, yet the ACLDS records do not indicated that they have been readjusted. Furthermore, final readjustment status -- either proper and improper -- was found for leases whose readjustment date was subsequent to these leases. A list of these leases is attached.

We are writing today to seek further information from the Department to determine the readjustment status of these leases.

We recognize that some of these leases are subject to internal appeals to IBLA or federal court suits. In other cases, data in district and state offices may not yet have been entered into the system. However, we are concerned that the Department's records do not reflect the appropriate readjustment status. According to the Department's regulations:

> The readjusted lease terms shall become effective either 60 days after the lessee is notified of them, or if the Attorney General desires to review the readjustment 30 days after the authorized officer transmits the required information to the Attorney General, whichever is later. 43 CFR 3451.2(c)

Clearly, one paramount concern that is raised is whether or not these 63 leases, particularly the seventeen that recorded production in 1983, are paying the appropriate royalty. While the filing of an appeal suspends the obligation to pay higher royalties, the readjusted lease terms and conditions are effective immediately and the higher royalties are supposed to accrue during the pendency of the appeal. 43 CFR 3451.2(e). It is not clear if effective mechanisms are in place to insure that those who lose appeals do, in fact, pay the higher royalty in light of the fact that the ACLDS records do not reflect the higher royalty as being effective.

As you are undoubtedly aware, because we have discussed the matter, the Department, in a significant departure from past practice, refused to provide WORC with either 1984 production data or any royalty collection data. In response to inquiries on this matter, we have been told that the decision to withhold this data was made by the Minerals Management Service. The department also refused to make available other information -- collected at government expense by government personnel -- on coal quality.

Given the past record of the Minerals Management Service and its predecessors in collecting royalties owed the government, we view its decision to shield information on what royalties it has been assessing and collecting with some alarm. The notion that either the amount of coal produced by a mine or the prices charged for that coal is some form of "trade secret" is ridiculous on its face. Such data is routinely made public before the FERC and state public utility commissions where the coal is mined for steam electric generation, and by States collecting severance taxes. Thus, divulging royalty collection data would not reveal information about a coal company's financial arrangments which is not elsewhere public, it would only reveal information about whether or not MMS was doing its job.

The treatment accorded WORC in response to its FOIA request is in marked contrast with that given McGraw-Hill. In 1980 the Department made available to McGraw-Hill over 350 items of data on each coal lease including seam-by-seam coal quality data, FOB mine price, overbuden, seam dip and maximum stripping limit. This data, on the 558 leases outstanding as of January 1, 1980, was published in Federal Coal Leases: Marketing, Management and Financial Profiles. With repesct to leases issued since that date, all of the requested data, except the royalty collection data, is routinely published in tract profiles and sale notices . In light of this past practice, it is difficult to determine why far less sensitive data has been denied WORC unless it is being done as part of a policy to make collection and analysis of the data more difficult.

Given the past history of the coal leasing program, we do not feel that either the public or the Department are well served by a policy which withholds information on whether or not royalties required by law are, in fact, being collected. We recognize that you have, in the past, been a strong proponent of making this data public and hope that you can act to resolve this matter, as well as clear up the confusion regarding the readjustment status of the above listed leases.

Sincerely,

David Charles Masselli
Washington Counsel
Western Organization of
Resource Councils

Federal Coal Leases With Undetermined Readjustment Status

Serial #	Date	Lessee	Acreage	1983 Prod (MM Tons)
SL031286	09/04/23	Plateau Mining	1791.12	0.803
C033800	10/08/24	Ark Land Company	397.75	0.229
D034365	10/25/24	Colowyo Coal Company	2544.79	3.026
D051698	09/11/41	Ruby Construction Co	146.26	0.000
SL062583	09/11/41	Coastal States Energy	2199.83	0.738
SL063058	08/03/42	AMCA Coal Leasing	400.00	0.036
S032582	09/09/43	Thomas Reese	80.00	0.000
SL062966	11/12/43	Kaiser Steel	1366.89	0.011
SF077115	07/27/44	Floyd Ingraham	160.00	0.000
SL064507	11/01/44	Nevada Electric Invest	320.00	0.000
D052558	12/14/44	United States Steel	*	0.000
SL064900	02/03/45	Utah Power & Light	160.00	0.000
D052547	03/01/45	Colorado Yampa Coal	1145.13	0.000
W054727	11/01/61	Ark Land	1263.72	0.048
W054728	11/01/61	Ark Land	640.00	0.000
W054737	11/01/61	Ark Land	320.00	0.133
U067498	01/01/62	Kanawha & Hocking Coal	501.70	0.000
U020305	03/01/62	Coastal States Energy	1439.40	0.136
U040151	03/01/62	Cooperative Security Corp	1720.00	2.650
U053995	03/01/62	Coastal States Energy	160.00	0.000
U083066	03/01/62	Cooperative Security Corp	2485.00	0.108
U089096	07/01/62	Sunoco Energy Development	480.00	0.000
U090231	11/01/62	Consolidation Coal	2496.62	0.000
U092147	12/01/62	Sunoco Energy Development	680.00	0.000
C023703	03/01/63	Western Fuels Utah, Inc	2557.22	0.000
W061421	03/01/63	FMC Wyoming Corp	1280.00	0.000
W061422	03/01/63	FMC Wyoming Corp	1920.82	0.000
C024998	10/01/63	Powderhorn Properties	2550.92	0.210
C081330	11/01/63	Colorado Yampa Coal Co	2215.28	0.197
U0126947	12/01/63	Kaiser Steel Corp	1992.15	0.000
U0126948	12/01/63	Kaiser Steel Corp	2523.22	0.000
U073120	02/01/64	Kanawha & Hocking	557.22	0.299
C0114093	05/01/64	Peabody Coal Company	1320.00	0.000
U083005	08/01/64	Swanton Energy Resources	640.00	0.000
U084923	08/01/64	McKinnon Marital Trust	2252.42	0.054
U084924	08/01/64	McKinnon Marital Trust	1211.48	0.000
U0142235	10/01/64	Coastal States Energy Co	520.00	0.000
C029889	11/01/64	James Brothers Coal	2522.37	0.014
M065329	12/01/64	Geo Resources Exploration	320.00	0.000
U083000	12/01/64	Swanton Energy Resources	1440.00	0.000
C0115606	01/01/65	Mid Continent Resources	80.00	0.000
C0125485	01/01/65	United States Steel	200.00	0.000
C12638	01/01/65	United States Steel	315.29	0.000
C7853	01/01/65	United States Steel	717.32	0.000
U0140770	01/01/65	Utah International Inc	518.60	0.000
W0220516	03/01/65	Gulf Oil	1571.13	0.000

Federal Coal Leases With Undetermined Readjustment Status

Serial #	Date	Lessee	Acreage	1983 Prod (MM Tons)
W0256563	03/01/65	Gulf Oil Corporation	756.01	0.000
C081251	05/01/65	Material Service Corp	2519.03	0.000
C081258	05/01/65	Material Service Corp	2323.44	0.000
C0117192	06/01/85	ARCO	1243.49	0.000
U0101213	06/01/65	Consolidation Coal	2161.57	0.000
U0101214	06/01/65	Consolidation Coal	2314.25	0.000
U0101215	06/01/65	Consolidation Coal	856.40	0.000
U0101217	06/01/65	Consolidation Coal	640.00	0.000
U0101218	06/01/65	Consolidation Coal	1880.00	0.000
U0105404	06/01/65	Utah International	1529.42	0.000
U098774	06/01/65	Utah International	2487.60	0.000
U098775	06/01/65	Utah International	1599.36	0.000
W0312918	06/01/65	Pacific Power & Light	3779.30	0.000
W0313550	06/01/65	Resource Development Co	640.00	0.000
M069782	07/01/65	Spring Creek Coal	2385.02	0.000
W0312311	07/01/65	Kerr-McGee Coal	880.00	0.000
** TOTAL **				
			80118.54	8.692

Federal Coal Leases Improperly Adjusted

Serial #	Date	Lessee	By	Acres	1983 Prod (MM Tons)	Royalty (cents/ton)	IBLA Cite
C011646	10/01/58	Mid Continent Resources	BLM	956.60	0.000	15.0	
C0125457	10/01/58	Mid Continent Resources	BLM	1142.31	0.000	15.0	
C012894	12/01/56	Franklin Real Estate	IBLA	634.42	0.000	15.0	71 IBLA 13
C020740	10/01/58	Pitkin Iron Corp	IBLA	40.00	0.041	15.0	81 IBLA 81
C037277	10/01/62	Pitkin Iron	BLM	1471.37	0.000	15.0	
C07518	06/01/58	Utah International	IBLA	2566.44	0.966	15.0	63 IBLA 363
C07519	06/01/58	Utah International	IBLA	1371.82	0.000	15.0	63 IBLA 363
C079641	10/01/62	Utah International	BLM	1351.84	0.000	15.0	
C09005	11/01/58	Mid Continent Resources	BLM	1365.40	0.000	15.0	
D047201	07/25/36	Western Fuels	IBLA	513.00	0.000	*	63 IBLA 363
D042921	02/25/31	Western Slope Carbon	IBLA	818.53	0.000	*	63 IBLA 363
D056724	07/23/51	Western Slope Carbon	IBLA	189.24	0.000	*	63 IBLA 363
E018804	03/28/38	Conotton Land Company	BLM	160.00	0.000	15.0	
NM065466	01/01/64	Gulf Oil Corp	BLM	2560.00	0.000	22.5	
SL048442	11/21/30	Franklin Real Estate	IBLA	2562.88	0.000	*	63 IBLA 363
SL050862	08/05/37	W.A. Land Company	BLM	280.00	0.000	15.0	
SL058575	10/08/36	Nevada Electric Investmen	IBLA	155.74	0.000	*	63 IBLA 363
SL062605	03/17/39	Kanawha & Hocking Coal	BLM	1052.68	0.000	15.0	
SL064903	01/24/46	Beaver Creek Coal	IBLA	160.00	0.000	*	63 IBLA 363
SL068754	06/01/51	United States Steel	IBLA	2570.67	0.000	*	63 IBLA 363
SL069291	04/01/50	Kaiser Steel	IBLA	600.00	0.000	*	63 IBLA 363
SL071737	09/01/50	Franklin Real Estate	IBLA	1960.00	0.025	*	63 IBLA 363
U01215	06/01/51	United States Steel	IBLA	*	0.000	*	63 IBLA 363
U017354	09/01/56	Kanawha & Hocking Coal	IBLA	1028.47	0.166	*	63 IBLA 363
U020641	05/01/61	Kanawha & Hocking	BLM	1908.66	0.000	15.0	
U020668	05/01/58	Beaver Creek Coal	BLM	626.32	0.000	15.0	
U25485	09/01/50	Franklin Real Estate	IBLA	543.42	0.000	*	63 IBLA 363
U02785	07/01/52	Kaiser Steel	IBLA	2360.00	0.000	*	63 IBLA 363
U039706	07/01/60	Kaiser Steel Corp	IBLA	2559.16	0.000	15.0	76 IBLA 387
U062453	03/01/62	Coastal States Energy	IBLA	480.00	0.680	*	70 IBLA 385
U073039	06/01/62	Consolidation Coal	IBLA	2576.86	0.000	17.5	87 IBLA 296
U073040	06/01/62	Consolidation Coal	IBLA	2542.25	0.000	17.5	87 IBLA 296
U073041	06/01/62	Consolidation Coal	IBLA	2557.99	0.000	17.5	87 IBLA 296
U07746	06/03/57	Sunoco Energy Development	BLM	2480.00	0.000	15.0	
U38727	05/01/58	Beaver Creek Coal	BLM	740.39	0.000	15.0	
U46484	05/01/58	Nevada Electric Investmen	BLM	1400.00	0.000	15.0	
W030052	11/01/59	Texaco Inc	BLM	2203.35	0.000	15.0	
W038697	08/01/58	Pacific Power & Light	BLM	1400.00	0.226	15.0	
W055246	03/01/58	Gulf Oil Corp	BLM	2402.93	0.099	15.0	
W073289	05/01/59	Wyodak Resources Developm	BLM	240.00	1.545	15.0	
W075206	01/02/59	Gulf Oil Corp	BLM	1246.98	0.000	15.0	
W075207	01/02/59	Gulf Oil Corp.	BLM	719.78	0.000	15.0	
				54499.50	3.748		

The **Chairman**. Thank you very much, and again I want to express my thanks to you for the study that's gone into the statement. I recognize that sometimes we listen in a very cursory way to testimony that's taken a lot of work to produce. We will look at it very carefully and I do appreciate particularly, Mr. McCormick, your statement that the amendment which I have—one of the two amendments that I have introduced with respect to the 2(c) issue may be a basis upon which to find a compromise.

As I have said before and I say again today, I still believe that 2(c) ought to be repealed and we'll settle those other issues in some other manner, and I think the national interest will be served best that way—which one of my amendments would accomplish.

The other is a genuine effort on the part of myself, and reflected on the part of others, to find a compromise between those who want outright repeal and those who want nothing. And I guess there are issues upon which no compromise should ever be offered or taken, and there are other issues that benefit from the constructive efforts of people with different viewpoints to find a common ground in between.

And that's the spirit in which that compromise amendment has been offered. I want to commend the affiliates of railroads for having gone farther than I thought they would be willing to go in offering assurances against the specific criticisms that have been raised by your organization and by others in the coal industry that fear the competitive advantage that might come from the repeal of 2(c) or the leasing of those lands in the checkerboard area.

Mr. **Yeager**. Mr. Chairman, might I make one comment for the record?

The **Chairman**. Surely.

Mr. **Yeager**. I listened carefully to the last panel and a number of witnesses asserted that the Linowes Commission had recommended the repeal or substantial modifications——

The **Chairman**. I noted that portion of your statement which says that's not true.

Mr. **Yeager**. I just wanted to clarify that. Thank you very much.

The **Chairman**. Yes, sir.

Somehow, somewhere, we need to resolve that issue. I'm also thankful that each of you in your own way has said maybe repeal of section 3 isn't right, but maybe some modification of its strict application, either by regulation or by modification of the law, is in order.

I think both of those indicate that indeed there is a way to solve that problem without throwing the baby out with the bathwater. And perhaps growing from that, we can in this committee, as we go through the deliberations, find the means by which the common objectives can be found even where differing objectives will never be resolved.

Mr. **Masselli**. Mr. Chairman.

The **Chairman**. Mr. Masselli.

Mr. **Masselli**. I'd also just like to briefly—none of us raised it, but I think all of our statements also address the issue of logical mining units, and I think you'll find that that's an issue where we have all said that we believe again there is grounds for recasting the law or perhaps regulations, so that the kinds of problems that were mentioned in the earlier panel will not arise.

The concern we've always had is just that you don't want a situation where two mammoth mines that are 25 miles apart can treat themselves as a logical mining unit. But I think that short of that, this is another area—as I say, it's unfortunate that section 7 gets so much of the play, because I think on some other areas that we're talking about, all of us who've had experience with the coal program realize that there is a place for certain elements of compromise and we are not that far apart on those—section 7's, LMU, et cetera.

Thank you.

The CHAIRMAN. I hope we find those areas of compromise. Again, I thank you and your organizations for your work and your testimony today.

We will next hear from a panel: Mr. Hugh Garner, Salt Lake City, UT, on behalf of Blackhawk Coal Co.; Mr. Ken Williams from Western Energy Co. in Butte, MT; and Mr. Olson, Meeker, CO.

If you gentlemen will please come forward.

[Pause.]

The CHAIRMAN. Gentlemen, pursuant to our practice, we will ask that you summarize if, indeed, you can make a few of the high points in a brief manner, and your statements will appear in the record in full as if delivered.

Mr. Garner.

STATEMENT OF HUGH C. GARNER, ATTORNEY AT LAW, HUGH GARNER & ASSOCIATES, ON BEHALF OF THE BLACKHAWK COAL CO.

Mr. GARNER. Mr. Chairman, I am Hugh Garner from Salt Lake and I am here on behalf of Blackhawk Coal Co. which is an operating entity and a wholly owned subsidiary of American Electric Power. They operate a mine in the Helper-Price, UT area.

I also speak for Peter Kiewit & Sons, Inc. of Omaha, NE, which operates under the name of the Big Horn Coal Co., with deposits in the Sheridan, WY, area and the Rosebud Coal Sales Co., operator of the Rosebud mine near Hannah, WY.

I was a part of the administration in 1976 which saw the passage of this legislative baby, and it was a period of stress and reaction, and, I think, personally the baby is of an age now that it could respond to orthodontic treatment and maybe some treatment for its acne.

I think I agree with the major number of speakers; it is time for an overhaul of the legislation.

But I am not speaking, Mr. Chairman, to any of the features that have been the discussion this morning. I am going to be quite parochial in my approach, and I am going to be talking about coal lease royalties and offering some suggestions which, I think, may be of help to the industry and the public in a number of respects.

In my reading of the bills under consideration, I see nothing which directly addresses our concerns in this connection.

I think it is important to understand the motivation, Congress' motivation in framing the laws of 1872 and the Mining Mineral Leasing Act of 1920. The main thrust was to promote the development of mining on the public domain. And these were acts which provided a number of incentives.

And it was in the public interest to bring industry to the West and to people it and to develop it. And in encouraging this activity, the Government chose not to exact any onerous development requirements or financial payments. On the face of it, a 15- or 20-cent per ton coal mined royalty is very low. But the indirect return can have some very impressive reactions inasmuch as it has created whole communities.

Now, there are two sections in the present 1976 act; that is sections 207 and 209, which in my mind, for my clients have created some very real problems for the industry. Section 207 raises the royalty rate on coal to a minimum of 12½ percent of the value of the coal mined, although the regulations provide for a lower royalty on coal mined underground.

Section 209 provides that the Secretary of the Interior, for the purpose of encouraging the greatest ultimate recovery of coal, and in the interest of conservation of natural resources, is authorized to waive, suspend, or reduce the rental or minimum royalty whenever, in his judgment, it is necessary to do so in order to promote development or whenever, in his judgment, the leases cannot be successfully operated under the terms provided therein.

The Department has decided as a matter of policy that all 1976 Amendment Act provisions to be applied to pre-1976 leases upon their next readjustment, including the above minimum royalty rates. The Department has taken a position that the royalty reduction is not available upon readjustment because the remedy available is under section 209.

So here is where you get this catch-22. Section 209 provides that the lessee operator can apply for a royalty reduction, but no royalty reduction will be granted until reduction guidelines are in place. And the guidelines are not in place yet. We stand with Blackhawk with a royalty reduction application that was filed over 18 months ago, and the district supervisor has not even looked at it; has not processed it because he has the excuse that Department policy dictates that there will be nothing in the way of a readjustment action until the guidelines are in place.

I might say, too, in the preliminary hearings on the proposed guidelines, they did little to ease our concerns about the regulatory agencies, particularly MMS, which appeared to be totally unresponsive to the original congressional intent or to the realities of the western coal industry and those dependent on it.

So I am going to make some suggestions to the committee because I have seen in instances here where, under lease readjustments, royalty rates have been raised, increased as much as 2,000 percent. And under the scheme that the Department presently offers, there is no way that we can get any relief. And I am saying in my suggestion to the committee, that perhaps Interior through this legislation, as overhauled, could be given some direct instructions as to how to apply this.

So I would recommend that there be included in the bill a section would define an effective date; in other words, the act would affect those coal leases issued under the act after August 4, 1976, and that there would be a special effective date for certain leases such as pre-August 4, 1976, leases.

Departmental readjustments of pre-1976 leases occurring after enactment of the legislation you are considering today would defer the mandatory royalty rate increases for 10 years after such readjustment. With respect to pre-August 4, 1976, leases readjusted before enactment of the legislation under consideration, the royalty rate increase would not take effect until 10 years after such readjustment if the royalty rate increases were the subject of one or both of the following—and that is, a protest or objection pending as of the date of the enactment of this legislation before the Bureau of Land Management or the Interior Board of Land Appeals or an action pending as of the date of the enactment in the U,S. District Court or Circuit Court of Appeals.

The next point I would make is that mandatory royalty rate increases should be phased in. For any of the leases in these categories I have just mentioned, the Secretary would by rule or order establish lesser royalty rates for each year before the new mandatory royalty rate takes effect.

In other words, I am saying at the time of readjustment, there is a mandatory royalty rate fixed, and that royalty rate would not be necessarily 12½ percent minimum. It would be what conditions at the time and the location of the mine—let me digress for just a second.

The Blackhawk mine is current producing coal—well, it has not produced coal; it is in a temporarily suspended status right now since January of this year. But when it was producing coal and is producing coal from leases that were as old as 1927, Federal and State and some fee leases, it was producing coal at a 3,000-foot depth with poor roof conditions. They had to have roof bolts at very close intervals, pitching floors, and they had already invested in a two-compartment shaft, over $64 million to bring that coal to the surface. That is quite a hike for 3,000 feet lift.

So I am not saying the fact that they are shut in and the community has lost between 300 and 400 jobs for the past 10, 11 months—I am not attributing that to the royalty alone. There are other conditions in the market that have contributed to that. But it is a factor and a very strong factor.

So what I would say is that the Secretary would establish this lower rate, not necessarily be bound by the 12½ percent mineral, but something that would reflect the conditions of that mine and the economics of the production.

And then the royalty rate for the first year following readjustment would be the royalty rate in effect on August 4, 1976. Each succeeding year would have an incremental increase, and final royalty rate, as determined by the Secretary pursuant to either section 207 or 209, would be in effect 10 years after the adjustment. This would provide for a smooth transition and a gradual absorption of increase.

It would provide the operator a chance—which is not available to him under the present scheme—to plan for and accommodate the royalty rate increases, and this would do away with this retroactive issue that we now face.

So that the scheme would be to give to the operator a plan that was manageable and understandable and which he could accommodate.

I would just make one last comment, Mr. Chairman, and that is when the 1976 act went into effect, there were a lot of special interest groups and Members of Congress espousing the position that the Government must receive a fair return from the exploitation of a public resource—in this case, coal. And that is all well and good when it is viewed from the Washington perspective, but it is terribly unreal when you get out in the field and you view it from the standpoint of the economic practicalities facing an operator.

I am saying that there are many aspects to be considered in analyzing a fair return which can be, in economic and social terms, much more important in financial terms than the return to the Government an excessively high royalty rate. For example, their contributions of a profitable mining operation, capital, new jobs, large tax base, and aid of local as well as national economies.

That basically, Mr. Chairman, is our proposal. It is limited and parochial in its approach, but we are not wrestling with the big 2(c's) and 3's and 7's, but we think this of vital interest.

[The prepared statement of Mr. Garner follows:]

STATEMENT OF HUGH C. GARNER BEFORE THE SUB-COMMITTEE ON NATURAL RESOURCES DEVELOPMENT AND PRODUCTION ON NOVEMBER 8, 1985

Mr. Chairman:

I am most appreciative of the opportunity to make a statement to this Committee with respect to Senate Bills S.570, S.320 and S.946 which are intended to amend the Mineral Leasing Act of 1920, in certain respects.

I appear on behalf of Blackhawk Coal Company which is an operating entity and a wholly owned subsidiary of American Electric Power Company. The properties operated by Blackhawk Coal Company are an amalgam of federal, state and privately owned lands located in the Helper-Price, Utah area.

I also speak for Peter Kiewit & Sons, Inc. of Omaha, Nebraska, which operates under the name of Big Horn Coal Company, mining coal deposits in the Sheridan, Wyoming area, and the Rosebud Coal Sales Company, operator of the Rosebud mine in the Hannah, Wyoming area.

In 1976 I was a member of the administration which saw the passage of the Federal Coal Leasing Amendments Act ("FCLAA"). At that time it was my impression that the 1976 Act bordered on the repressive and punitive. On present reflection I think my early impressions were quite correct. I concur with many who feel that there should be an overhaul of the Act.

In my statement today I do not offer a panacea for the current depressed state of the Western Coal Industry. Rather, I intend to be quite parochial in my approach. I intend offering the committee several suggestions primarily with respect to coal lease royalties which could be helpful to the industry and the public in a number of respects. In my reading of the several Bills under consideration I see nothing which directly addresses our concerns in this connection.

Initially, it is important to understand the motivation of Congress when it formulated the Mineral Leasing Act of 1920. The Act was entitled "an Act to promote the mining of coal, phosphate, oil, oil shale, gas and sodium on the public domain" (43 Stat. 437).

Like the Mining Laws of 1872, the basic Mineral Leasing Act of 1920 was designed to encourage individuals to invest their time, money and effort in the development of the nation's natural resources. It was in the public interest to bring industry, growth, development and people to the western regions. To encourage such activity, the government chose not to exact onerous development requirements or financial payments. Royalty rates, for example, were as low as $.15 to $.20 per ton of coal mined. On the face of it, the direct return to the government may seem low but the indirect return - the development of a natural resource and an entire region - was impressive.

There are two sections of the existing Act (Sections 207 and 209 of FCLAA) which have created very real problems for the industry. Section 207 raised the royalty rate on coal to a minimum of "12 1/2% per annum of the value of the coal" mined, although regulations set the minimum royalty for coal mined underground at 8%. Section 209 provides that:

> the Secretary of the Interior, for the purpose of encouraging the greatest ultimate recovery of coal . . . and in the interest of conservation of natural resources is authorized to waive, suspend or reduce the rental, or minimum royalty . . . whenever in his judgment it is necessary to do so in order to promote development, or whenever in his judgment the leases cannot be successfully operated under the terms provided therein. (Emphasis mine)

The Department of the Interior has decided, as a matter of policy, that all FCLAA provisions are to be applied to pre-FCLAA leases upon their next readjustment including the above minimum royalty rates. Further, the Department has taken the position that a royalty reduction is not available upon readjustment because of the remedy available under Section 209. However, Section 209 provides that the lessee/operator can apply for a royalty reduction, which in turn gives rise to a Catch 22 situation because no royalty reductions will be granted until reduction guidelines are in place. And the Department has yet to adopt guidelines. Further, the Department's proposed guidelines do very little to ease our concerns about regulatory agencies which appear to be totally unresponsive to the original Congressional intent or to the realities of the Western Coal Industry, and those dependent upon it.

The end result is a situation where coal operators have experienced royalty increases, through lease readjustments, as great as 2000% yet they cannot currently get relief in the form of royalty reductions. Many of them are finding that they cannot make ends meet. Whole communities are affected. Some coal operators have long-term contracts which allow these royalty increases to be passed along, but passed to whom? Often it is the consumer, by virtue of higher utility rates, who must bear the brunt of the increase, and this is where Congress can, very possibly, witness a grass-roots revolution.

If we are to believe that there is any meaning in the preamble to the Mineral Lease Act, that it is, an Act "to promote" the mining of coal etc., I can only say that present policy is not accomplishing that end. I believe that if there are to be royalty increases on pre-1976 leases such increases must come slowly and manageably.

Thus, I would recommend the following:

1) An effective date should be defined in the Act; in other words, the Act would affect those coal leases issued under the Act after August 4, 1976;

2) That there be a special effective date for certain leases such as pre-August 4, 1976 leases. Departmental readjustments of pre-1976 leases occurring after the enactment of the legislation currently under consideration, would defer the mandatory royalty rate increases for ten years after such readjustment. With respect to pre-August 4, 1976 leases readjusted before enactment of the legislation now under consideration, the royalty rate increase would not take effect

until ten years after such readjustment if the royalty rate increases were the subject of one or both of the following:

a) a protest or objection pending (as of the date of the enactment of the legislation now under consideration) before the Bureau of Land Management or the Interior Board of Land Appeals;

b) an action pending (as of such date of enactment) in United States District Court or Circuit Court of Appeals.

The next point I would make is that mandatory royalty rate increases should be phased-in. For any lease in any of the categories I have mentioned, the Secretary would, by rule or order, establish lesser royalty rates for each year before the new mandatory royalty rate takes effect. The royalty rate for the first year following readjustment would be the royalty rate in effect on August 4, 1976. Each succeeding year would have an equal incremental increase so that the final royalty rate as determined by the Secretary pursuant to Section 207 or 209 would be in effect ten years after the readjustment. This would provide for a smooth transition and gradual absorption of the increase. It would provide the operator a chance, which is not available to him under the present scheme, to plan for and accommodate the royalty rate increase. This would do away with the "retroactive" issue we now face.

At the time of the framing of the 1976 Act, Congress and the Department of the Interior overreacted to the clamor of special interest groups and certain members of Congress espousing the position that the government must receive a "fair return" from the exploitation of a public resource, in this case coal. This is all well and good when viewed from the Washington perspective but terribly unreal when viewed from the standpoint of the economic practicalities facing the operator. There are many aspects to be considered in analyzing a "fair return" which can be, in economic and social terms, much more important in financial terms than the return to the government from an excessively high royalty rate. For instance, there are the contributions of a profitable mining operation to capital, new jobs, and an enlarged tax base in aid of the local, as well as the national economies.

It is my sincere hope that Congress, in amending the Act, will consider as paramount the needs and welfare of the industry, the communities and the people they serve, by accommodating our concerns.

Thank you, Mr. Chairman for this opportunity.

The CHAIRMAN. Thank you, Mr. Garner.
Mr. Williams.

STATEMENT OF KENNETH L. WILLIAMS, DIRECTOR, GOVERNMENT AFFAIRS, WESTERN ENERGY CO.

Mr. WILLIAMS. Thank you, Mr. Chairman. I'd like to summarize my testimony. For the record, my name is Kenneth Williams. I'm director of Government Affairs for Western Energy Co. in Butte, MT. And Western produces coal in Texas, Wyoming, and Montana. Since 1968 we've produced about 125 million tons of coal, 50 million tons of which has been Federal.

All our Federal leases are associated with an operating mine.

Mr. Yeager mentioned some possible technical areas with the act that might be available. Well, I'd sure like to throw out a couple. One of the problems that the 1976 act did was made coal leases be subject for 20 years and so long thereafter as coal is produced in commercial quantities—failed to recognize that at some point, coal production is going to cease from that lease, and that lease is going to be mined out. But in 1977, SMCRA required us to hold the lease for an additional 10 years after we finished mining, for reclamation purposes.

There has to be some sort of recognition that a lease can be mined out. We have a pre-SMCRA lease that is now essentially mined out and is kind of caught in this continuous operation problem.

One of the other areas that might need some adjustment is the logical mining unit concept. And one of the earlier members of the panel talked about the continuity problem, and that is a problem. Additionally, the acreage requirement on the logical mining units is a problem, particularly in checkerboard areas.

But I would like to turn primarily to the royalty issue and I would like to mention that Mr. Garner has pointed out some of the problems associated with readjustment. One of the things that sort of exacerbates this problem is the fact and the manner in which coal royalties are calculated and the computation of the coal royalties. The large increases in percentages could be ameliorated somewhat if the Department did not interpret its mandate on coal royalties to apply against all elements of the price, such as the State production tax, the Federal Black Lung tax, the Federal reclamation fee.

What happens by applying the coal royalty against all elements of the price is the simple adjustment on the State or Federal scene can have an immediate impact on the Federal royalty. The current proposal around to make some adjustments to the Federal Black Lung tax would have the immediate impact of increasing the Federal coal royalty.

We feel that the proper method of computation for Federal coal royalties should be on the nontax portion of the price, the nontax, nonfee portion of the price.

And the Linowes Commission recognized this problem in part when it recommended that State severance tax and other similar taxes be exempted from the base used for royalty calculation purposes. And in Montana, our State legislature addressed this problem in part in 1983 when we allowed a deduction for certain Federal, State, and Indian royalties for the purpose of severance tax calculation; in other words, to break that iterative calculation.

There are three basic problems that have happened because of the change to the royalty. One, you've got that massive increase that Mr. Garner talked about from 800 to 2,000 percent, depending on the operation involved. Second, you've got the situation that I just outlined with the calculation problem. And third, you've got coal (a) that is being produced at one royalty and coal (b) that's being produced at another, and this leads to some market disruption.

Part of the original logic for the 12½ percent or the percentage royalties in general was to keep the money whole. We would suggest that a study ought to be performed and maybe some consideration given to going back to a set royalty and tying it to an escalator, rather than basing it on a percentage basis.

We'd like to play on a more even field. And that's really about my testimony.

Thank you.

[The prepared statement of Mr. Williams follows:]

STATEMENT OF KENNETH L. WILLIAMS

DIRECTOR OF GOVERNMENT AFFAIRS
WESTERN ENERGY COMPANY
BEFORE THE
SENATE ENERGY COMMITTEE
S.372, S.570, S.946
NOVEMBER 8, 1985

Mr. Chairman, members of the Committee, my name is Kenneth L. Williams. I am Director of Government Affairs for Western Energy Company. We appreciate the opportunity to testify on S.570, S.372, S.946 and coal leasing. Western is a wholly owned subsidiary of Entech, the nonutility subsidiary of the Montana Power Company. Western and its subsidiaries operate coal and lignite properties in Montana, Wyoming and Texas.

Our operations in Montana at the Rosebud Mine at Colstrip produced nearly 12 million tons in 1984. We project similar tonnage for 1985. Since 1968, Western has produced approximately 125 million tons at Colstrip from a checkerboard mineral ownership pattern. Approximately 50 million tons of that production has been federal coal.

Western is concerned with certain areas in any contemplated revisions to the Mineral Leasing Act. First we feel that changes are necessary to better implement the logical mining unit concept. In order to avoid situations of multiple LMU's for a single operation, adjustments to size, time limits, and the definition of contiguous lands will afford the Department a more efficient administrative tool. A recognition that coal leases will at some point be mined-out and will no longer be able to meet requirements of continued operations is also needed.

Western's Rosebud Mine consists of over 34,000 acres of coal lands. Of that total about 30,500 acres have been leased. Scattered throughout the reserve is some 3,480 acres of unleased federal coal. Due to the leasing moratorium and the necessity for emergency, short term leasing, Western holds eight federal coal leases at Colstrip.

However, due to the acreage restriction on logical mining units Western cannot form just one LMU for the Rosebud Mine. Forming multiple LMU's may cause situations where Western could have problems with Section 3 if leases were segregated and new numbers assigned. This might happen even though production is and has occurred on Western's pre 1976 federal leases.

One additional problem can be caused by the statutory language in the Act. Western only holds two pre 1976 federal leases. One of those leases readjusted in 1983 and was mined out shortly thereafter. Though diligence has been met, the requirements for continued operation leaves Western with a situation where there is no more coal to mine. We urge that the Act be modified to allow mined out leases to be held for reclamation purposes.

Western's major concern with federal coal development is the federal coal royalty and how gross value is determined for purposes of royalty calculations. Increases in federal royalties of 800 to 1000% as result of a change to percentage royalties may seriously impact the market for Western coal. The federal government controls the future of coal development in the West by virtue of its dominant ownership position. Federal decisions on royalties will impact negotiations with state and private mineral owners.

Currently the Department of Interior is interpreting its mandate on percentage royalties to apply against all elements of the price. Thus the percentage royalty applies to state production taxes and federal fees and federal production taxes as well as all other elements of the price. This leads to situations where an increase in a federal or state production tax results in an automatic increase in the federal royalty and thus in the price of coal. The current proposed increase in the Black Lung Tax is a good example. Should this tax increase, the federal coal royalty will automatically increase. Western Energy feels that this is an unjust and unfair method of calculating federal royalties.

Partial recognition of this problem was noted by the Linowes Commission when it recommended that state severance and other similar taxes be exempted from the base used for federal royalty calculation purposes.

The State of Montana has also taken steps to alleviate this situation. The 1983 Montana Legislature allowed a deduction of federal, state, and Indian royalties for purposes of state severance tax calculations.

It would seem unlikely that Congress intended the economic rent due to the government for its coals to artificially inflate by allowing percentage royalties to apply to and interact with other taxes and fees. Western urges you to act to change the base for federal royalty calculation to clearly exempt state and federal production taxes and fees. Western feels that the federal royalty, should apply against only the non-tax, non-royalty portion of the coal price. The electric consumer will benefit by slower increases in fuel costs to generating units which will help the United States products to remain more competitive in the world marketplace.

Western believes that the general subject of federal coal royalties deserves careful scrutiny. The effect of the percentage royalties is beginning to be felt in a more general manner. The change to percentage royalties will have three effects: (1) It will dramatically increase the cost, (2) this increase is exacerbated by the mathematical interaction between percentage royalties and percentage taxes and (3) there will be chaos in the market due to percentages being applied against different bases for each mining company dependant on geological conditions.

The logic for the 12½% rate for surface coal was in part a desire to hold the royalty value over time for the federal coal resource. Western recommends that Congress examine the concept of establishing a cents/ton federal royalty that is tied to an appropriate index. This will accommodate the desire to hold the value for the federal resource and would minimize market disruption.

Western feels that a dependable stable federal leasing program will nurture and efficiently utilize federal resources. Our most serious operating problems at Colstrip have stemmed from our inability to obtain federal leases in a timely and predictable manner. As mentioned previously, Western has eight federal leases at Colstrip due to the necessity of piece-meal leasing brought on by the leasing moratorium. This fact has required us to adjust mining plans, led to permitting difficulties and increased our costs. Western and any company needs stability in the leasing program to plan and mine efficiently.

Western wants to mine federal coal and our record reflects that fact. But in order to do so we must have timely access to reserves that can be mined in a safe, economic and environmentally acceptable manner. Increasing federal royalty costs to a point that distorts or destroys the market for Western coal benefits no one. We urge that federal royalties and the methods of calculation be seriously examined and modified.

we:07:0106

The CHAIRMAN. Thank you.
Mr. Olson.

STATEMENT OF E.K. OLSON, PRESIDENT AND GENERAL MANAGER, COLOWYO COAL CO.

Mr. OLSON. Thank you, and I appreciate the opportunity to present this testimony today. I am not a professional in presenting testimony. I'm a mining engineer. In fact, this is the first time I have had the opportunity to speak to such a distinguished committee.

My name is E.K. Olson. I am president and general manager of the Colowyo Coal Co. of Meeker, CO. Colowyo is a partnership owned by wholly owned subsidiaries of W.R. Grace & Co. and M.A. Hanna Co.

We would like to address today one important matter that this subcommittee and the Congress should consider. That matter is whether the Department of the Interior should have the authority to increase royalties for pre-1976 Federal leases to a uniform rate of 12½ percent, a value without any consideration of the circumstances surrounding the appropriateness of the increase to the specific lease it affects.

We respectfully request that Congress clarify by definitive legislation that the Department of the Interior must consider all pertinent facts in establishing a reasonable royalty and other terms to be imposed at lease readjustment.

By enacting the Mineral Lands Leasing Act of 1920, Congress established comprehensive procedures for leasing various federally owned minerals, including oil and gas, coal, sodium, and phosphates. Congress was particularly sensitive to difference in risk, capital intensity and the time required to exploit leasable minerals.

Two general types of leasing programs were enacted as a consequence of these differences:

One, for minerals such as sodium and phosphate, Congress provided for the issuance of determinate leases. Determinate leases provide the lessee (i) with a lease term sufficiently long, in most instances, to permit the deposit to be mined out before lease expiration, and (ii) provide the lessee with the right of first refusal to obtain a renewal lease containing terms prescribed by the Department of the Interior if mining is not completed by the end of the lease term.

Now, the second lease was for minerals such as coal, where exploration and development is significantly more intensive, more capital-intensive, where risks are substantially greater and where periods of time required to finance operations, to equip the mine, to obtain contracts, to market the mineral, and to mine out the deposit are significantly longer. Congress provided of indeterminate leases.

Indeterminate leases (i) provide the lessee with a lease of no stated term of years and (ii) authorize the Department of the Interior to readjust lease terms and conditions at the end of a specified period, as necessary to meet materially changed conditions.

The rationale for indeterminate leases is that they provide the lessee with the greater title security required to permit exploration and development of that mineral. The lessee is provided an indeterminate term within which to complete its mining plan and business plan to ensure fairness to both the lessor and the lessee; lease conditions may be reasonably readjusted at stated intervals to—in the words of Congress—meet materially changed conditions.

We submit that this practice, enacted by Congress and administered by the Department of the Interior for some 50 years, has proven sound and reasonable.

Grace, Hanna, and the Colowyo Coal Co. have developed the largest coal mine in Colorado. They have spent in excess of $100 million in capital costs on the Colowyo mine. They have built a 22-mile railroad spur to provide necessary transportation capacity to produce coal from the 1924 lease. They have employed and presently maintain a 396-person work force at the Colowyo mine.

These are typical, but not inclusive, of actions taken strictly in reliance on the security provided by the pertinent provisions enacted by Congress through the Mineral Lands Leasing Act of 1920, the 1924 lease, and the past practices established by the Department of the Interior over the past 50 years.

In 1984, the Commission on Fair Market Value Policy for the Federal coal leasing, commonly known as the Linowes Commission, concluded that there was no factual basis to support imposition of a 12½-percent royalty on Federal coal leases. The royalty was apparently adopted without economic study solely on the grounds that it coincides with the royalties imposed on oil and gas production.

Notwithstanding that finding, the Department of the Interior has continued to adhere to the position that it is without legal authority to consider whether the circumstances surrounding given lease operations should result in imposition of a lower royalty at the time of lease readjustment. Whether or not imposition of a 12½-percent royalty may be legitimate for new leases entered into by consenting parties after 1976, it is clearly not proper where the parties have previously entered into a contract several years prior to 1976 and have taken action in reliance on the firm commitments each of them has made.

The lack of any factual basis for a uniform 12½-percent royalty has severely complicated our relationship with our customers. We're the mine that's referred to as the 2,000-percent increase in royalties. Increases of our royalty payments by nearly 2,000 percent, without any factual justification, makes it very difficult for anyone to accept.

These complications will undoubtedly become even more severe when the electric consumers, such as the farmers in the Midwest and the ranchers of the West and the consumers in Texas, are asked to bear higher rates attributable to royalty increases.

To alleviate these problems, we submit that Congress should enact a provision of law clarifying that for leases issued before 1976, lease terms and conditions may be readjusted only as necessary to meet—in the words of Congress—I quote—"materially changed conditions" determined after an evaluation of pertinent circumstances. Unless such action is taken immediately, the problems identified above will not only remain unresolved; they will intensify the discord that has arisen among the Department of the

Interior, producers of coal under Federal coal leases, public utilities, and the electric consumers.

Thank you.

[The prepared statement of Mr. Olson follows:]

TESTIMONY OF E. K. OLSON

SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES

SUBCOMMITTEE ON NATURAL RESOURCES DEVELOPMENT AND PRODUCTION

November 8, 1985

Chairman Warner, Senator Melcher, and other members of the Subcommittee on Natural Resources Development and Production.

My name is E. K. Olson. I am President and General Manager of Colowyo Coal Company. Colowyo is a partnership owned by wholly-owned subsidiaries of W. R. Grace & Co. and M. A. Hanna Company. I am pleased to have this opportunity to submit this testimony on behalf of Grace, Hanna, and Colowyo.

Colowyo owns and operates a surface coal mine in northwest Colorado near Craig. The Colowyo Mine is the largest coal mine in Colorado with a permitted production capacity of 4.5 million tons per year. Almost all of the approximately 3 million tons of coal mined annually from the Colowyo Mine is produced from a federal coal lease issued by the Department of the Interior in 1924. Coal produced from the 1924 Lease is sold primarily to public utilities in Colorado and Texas.

ISSUE ADDRESSED

We would like to address today one important matter that this Subcommittee and the Congress should consider. That matter is whether the Department of the Interior should be permitted to increase royalties for pre-1976 federal leases to a uniform rate of 12-1/2 percent of value without any consideration of the circumstances surrounding the appropriateness of that royalty to the specific lease it is readjusting.

OUR POSITION

We respectfully submit that Congress should clarify by definitive legislation that the Department of the Interior has no such authority and must consider all pertinent facts in establishing a reasonable royalty and other terms to be imposed at lease readjustment. The bases for our position include the following:

1. Prior Congressional Action. In 1920 Congress enacted the Mineral Lands Leasing Act. That Act established comprehensive procedures for leasing various federally-owned minerals, including oil and gas, coal, and sodium and phosphates. In extended deliberations Congress concluded that varying leasing procedures were required for minerals treated by the legislation because of substantial differences in exploration and development of those minerals.[1] Congress was particularly sensitive to

differences in risk, capital intensity, and the time required to exploit leasable minerals.[2] Two general types of leasing programs were enacted as a consequence of those differences.

First, for minerals where exploration and development is relatively less capital intensive, where risks are less severe, and where development may be completed not long after exploration commences, Congress provided for the issuance of determinate leases. Determinate leases provide the lessee (i) with a lease term sufficiently long in most instances to permit the deposit to be mined out before lease expiration and (ii) provide the lessee with a right of first refusal to obtain a renewal lease containing terms prescribed by the Department of the Interior if mining is not completed by the end of the lease term. These leases, which generally provide the lessee with relatively less security of title, remain the standard for sodium and phosphate.[3]

Second, for minerals such as coal, where exploration and development is significantly more capital intensive, where risks are substantially greater, and where periods required to finance operations, to equip a mine, to obtain contracts to market the mineral, and to mine out the deposit are significantly longer, Congress provided for issuance of indeterminate leases. Indeterminate leases (i) provide the lessee with a lease of no stated term of years and (ii) authorize the Department of the Interior to readjust lease terms and conditions at the end of a specified period as necessary to meet materially changed conditions. The rationale for indeterminate leases is that they provide the lessee with the greater title security required to permit exploration and development of certain minerals.[4] The lessee is provided an indeterminate term within which to complete mining operations and, to ensure fairness to both the lessor and the lessee, lease conditions may be reasonably readjusted at stated intervals to, in the words of Congress, "meet materially changed conditions."[5]

We submit that this practice, adopted by Congress after extended deliberation and recognized by the Department of the Interior for some fifty years, is sound and reasonable. Present Department of the Interior policy requiring uniform imposition of royalties of 12-1/2 percent of value at the time of lease readjustment without any consideration of pertinent facts surrounding lease exploration and development flies in the face of that practice. Under present Department of the Interior procedures, a coal lessee is afforded substantially less security than an oil and gas lessee, notwithstanding the fact that coal exploration and development is ordinarily more capital intensive and typically requires substantially longer periods of time to complete. We submit that longstanding congressional policies are turned on their heads where an oil and gas lessee enjoys complete title security until development is completed but a coal lessee's rights are subject to major modifications without a case-by-case evaluation of the facts surrounding lease exploration and development.

2. Reliance of Coal Lessees. Grace, Hanna, and Colowyo have developed the largest coal mine in Colorado. They have spent in excess of $100 million in capital costs on the Colowyo Mine. They have built a 22-mile railroad spur to provide necessary transportation capacity to produce coal from the 1924 Lease. They have employed and presently maintain a 396-person work force at the Colowyo Mine. Each of these actions was taken in reliance on the security provided by the pertinent provisions of the Mineral Lands Leasing Act of 1920 and the 1924 Lease, precisely as Congress contemplated.

Even if the longstanding practice to provide title security to federal coal lessees were now subject to real dispute, we believe that any new policy should be applied only to issuance of new leases, not to readjustment of outstanding leases where lessees have already relied upon the lease contract. The parties to the lease contract have struck a deal and have taken action in reliance on it. Any change now deemed advisable should be prospective only.

3. Operational Problems. We have enjoyed excellent working relationships for many years with both the Department of the Interior and our coal customers. Our relationship with the

Department of the Interior has its foundation in our standing policy to comply fully with the letter and spirit of all legal requirements, a policy that has resulted in Colowyo receiving a number of reclamation and other operational awards. Colowyo's relationship with its customers has been based on its policy of close communications and sensitivity to customers' needs. Both of these critical relationships have been under great strain as a result of imposition of the 12-1/2 percent royalty at lease readjustment without any consideration of pertinent circumstances surrounding mining operations.

In 1984 the Commission on Fair Market Value Policy For Federal Coal Leasing, commonly known as the Linowes Commission, concluded that there was no factual basis to support imposition of a 12-1/2 percent royalty on federal coal lessees--the royalty was apparently adopted without economic study solely on the grounds that it coincides with royalties imposed on oil and gas production.[6] Notwithstanding that finding, the Department of the Interior has continued to adhere to the position that it is without legal authority to consider whether the circumstances surrounding given lease operations should result in imposition of a lower royalty at the time of lease readjustment. Whether or not imposition of such a 12-1/2 percent royalty is legitimate for new leases entered into by consenting parties, it is clearly not proper where the parties have previously entered into a contract and have taken action in reliance on the firm commitments each of them has made.

The lack of any factual basis for a uniform 12-1/2 percent royalty has severely complicated our relationship with our customers. Increases of royalty payments by nearly 2000 percent without any factual justification is difficult for anyone to accept. These complications will undoubtedly become even more severe when electric consumers are asked to bear higher rates attributable to royalty increases.

RECOMMENDATION

To alleviate these problems we submit that Congress should enact a provision of law clarifying that for leases issued before 1976, lease terms and conditions may be readjusted only as necessary to meet, in the words of Congress, "materially changed conditions" determined after an evaluation of pertinent circumstances. Unless such action is taken immediately the problems identified above will not only remain unresolved, they will intensify the discord that has arisen among the Department of the Interior, producers of coal under federal coal leases, public utilities, and electric consumers.

FOOTNOTES

1/ *See*, *e.g.*, Department of the Interior Solicitor's Opinion, "Sodium Lease Renewals," GFS (MIN) SO-4 (1982). *See also* n. 2.

2/ *See*, *e.g.*, Department of the Interior Solicitor's Opinion M-36939, 88 I.D. 1003, 1004-5 (1981); 51 Cong. Rec. 14945 (1914) ("The leasing periods provided for in the bill are indeterminate, so that lessees may be willing to expend the money necessary for the thorough equipment of a large mine.") (Comments by Rep. Thomson.); S. Rep. 352, 61st Cong., 2d Sess. 10 (1914).

3/ *See*, *e.g.*, 30 U.S.C. § 262 (1982). Determinate leases were issued for oil and gas during the years immediately following enactment of the Mineral Lands Leasing Act. To provide enhanced security oil and gas operators are now issued fixed-term leases with terms that are not subsequently modified by the Department of the Interior.

4/ *See*, *e.g.*, 88 I.D. at 1004.

5/ *See*, *e.g.*, 51 Cong. Rec. 14945 (1914) ("Provision is made in this bill for such an adjustment of the terms and conditions of the lease at the end of the 20-year periods as may *meet materially changed conditions*.") (Comments by Rep. Thomson.) (Emphasis added.); S. Rep. 352, 61st Cong., 2d Sess. 3 (1914) ("Conditions, however, *may materially change from time to time*, and for this reason provision was made for adjustment of terms and conditions at the end of 20-year periods. . . .") (Emphasis added.); H. Rep. 17, 62nd Cong., 2d Sess. 3, 4 (1916) and H. Rep. 668, 61st Cong., 2d Sess. 3, 4 (1914) (The Department of the Interior "may adjust each lease according *to the conditions that are present, having due regard for markets, transportation, and other conditions*." (Emphasis added.)

6/ *See*, *e.g.*, Linowes Commission Report at 314.

The **Chairman**. Thank you, Mr. Olson.

I thank each of you gentlemen for your testimony here today. I know of your interest. It's very obvious.

I think in view of the complexity of the subject, although we want to move forward, I think we'll keep the record open for a period of 2 weeks for responses in writing to the record, and we will have some written questions to submit for response in writing.

Again, I thank each of you gentlemen for your appearance and testimony here today.

That's the end of the list this morning, and I thank all participants. The committee will stand adjourned.

[Whereupon, at 1:17 p.m., the hearing was adjourned.]

BLANK PAGE

APPENDIXES

APPENDIX I

Responses to Additional Committee Questions

United States Department of the Interior
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20240

DEC 20 1985

Honorable John W. Warner
Chairman, Subcommittee on Natural
  Resources Development and Production
Committee on Energy and Natural Resources
United States Senate
Washington, D.C.   20510

Dear Senator Warner:

This is in response to your letter of November 19, 1985, in which you submitted additional questions following the recent hearing on coal leasing before the Natural Resources Development and Production Subcommittee. Our responses to the questions are enclosed.

Thank you for the opportunity to respond to the Subcommittee.

Sincerely,

Assistant Secretary - Land and
Minerals Management

Enclosures

QUESTIONS SUBMITTED BY SENATOR WARNER

1. THE DEPARTMENT'S SEPTEMBER ANALYSIS OF OPTIONS INDICATES THAT IF THERE IS A HOLDING FEE AND IT IS CREDITABLE AGAINST FUTURE ROYALTIES ON PRODUCTION, THE CONGRESS SHOULD CONSIDER LIMITING THE CREDIT SO THAT IT ONLY APPLIES ABOVE A CERTAIN LEVEL. THE ANALYSIS INDICATES THAT SUCH A LIMITATION WOULD MINIMIZE ANY MAJOR DISRUPTION IN THE FLOW OF REVENUES TO THE STATES.

(a) WOULD YOU EXPLAIN HOW THIS WORKS?

(a) As discussed in the November 8, 1985, testimony as well as in the September 1985 report, if holding fee payments are allowed to be credited against future royalties it is possible that actual production royalty payments could drop to zero in the early years of production from a lease. If production royalties in the first year or two are less than the cumulative holding fees paid prior to commencement of production, the entire production royalty due could be offset by the accumulated credits. This would lead to zero cash payments in the early years of production from a lease. We believe this possibility to be of concern to State and local governments which may rely on a stable flow of royalty revenues to assist in programs to mitigate any adverse economic and environmental impacts that may accompany coal development, or to serve as a significant portion of the State's general revenues. Accordingly, to provide a more stable lease payment revenue stream, it would be desirable to structure the holding fee as a minimum royalty payment with a crediting provision. Under this structure, a lessee could offset, with previously paid holding fees, only the amount of royalties due that exceed the minimum payment. An example of this minimum payment or limited crediting notion is contained in S. 570 which would permit crediting of previously paid fees only in excess of annual production royalties due above 1 percent of reserves. This is to be contrasted with S. 372 which is similar to S. 570 except that under S. 372 the fees are fully credited in any year.

The Department recommends that the minimum royalties, or holding fees, be based on .3 percent of recoverable reserves. For crediting purposes, therefore, the previously paid holding fees or minimum royalty payments would be creditable against production royalties due on that component of production that exceeds .3 percent of recoverable reserves produced in that year. The effect of this limiting measure is that, beginning in year 11 the lessee would always make a payment based on at least .3 percent of the recoverable reserves. The State's share of such payments would therefore always be greater than zero, independent of the amount of the accumulated credits.

1.(b) WHAT, IF ANY, WOULD BE THE IMPACT ON CORPORATE DECISIONMAKING OF SUCH A LIMITATION?

(b) Corporate decisionmaking will vary from company to company but given the September 1985 staff analysis, the impact appears to be minor. This is illustrated in Exhibit V-2 on p. 82 of the analysis. In that graph both S. 570 and S. 372 (introduced by Senators Wallop and Johnston respectively) are shown by a single line. This is because a graph of the effects of these two proposals, one including the limiting feature and the other not, can be represented by a single line, which indicates no significant difference in the impact on profitability to the firm and consequently no impact on corporate decisionmaking. That is, on a discounted cash flow basis, the basis upon which staff believes industry would evaluate such a limitation, there is no significant differences in the income flow.

1.(c) WHAT RANGE OF MINIMUM PAYMENTS WOULD THE CONGRESS CONSIDER BASED ON YOUR ANALYSIS, AND WHAT WOULD BE THE EFFECT ON BOTH THE FLOW OF REVENUES AND ON CORPORATE DECISIONMAKING?

(c) The dollar amount of the minimum payment which Congress should consider, based on our analysis would be different for different regions, owing to the value of the coal produced in various regions. Specifically, the Department recommends that the minimum payment be based upon .3 percent of the recoverable reserves, and that crediting against future royalties due on production be limited to crediting for that portion only that would be due in excess of the minimum. With respect to the flow of revenues, this would mean that in all years the government would never receive cash payments less than the minimum based on .3 percent of recoverable reserves. As previously indicated, the staff analysis suggests that the limiting feature itself is expected to have no discernable impact on corporate decisionmaking. The .3 percent basis would allow approximately a six year (from year 10 to 16) window of flexibility for getting a lease into production as compared with the current statutory inflexibility relative to the 10 year deadline, assuming a 1 percent real price annual escalation in the market price of coal. This 1 percent assumption should be considered high relative to what has been experienced in the market in recent years. Under the more realistic assumption of constant real prices (i.e., the price of coal increases no faster than the general level of inflation) no real flexibility would be accorded by the minimum royalty notion. This is because, with no expected real price increase to offset the cost of money suffered by the firm from paying the holding fee, each annual payment of the holding fee can be expected to irrevocably reduce profits by the cost of capital associated with each year's holding fee, even assuming that the lease is eventually developed and the previously paid fees are creditable.

1.(d) HOW IS THE LEVEL OF THE MINIMUM ROYALTY RELATED TO THE SIZE OF THE HOLDING FEE?

(d) The level of the minimum royalty recommended by the Department is equal and identical to the size of the holding fee.

2. YOUR ANALYSIS INDICATES THAT THE CONGRESS NEEDS TO PAY CLOSE ATTENTION TO THE TAX CONSEQUENCES OF IMPOSING A HOLDING FEE. YOUR ANALYSIS WOULD INDICATE THAT THE GRADUATED FEE PROPOSED UNDER S. 372 AND S. 570 WOULD NOT BE DEDUCTIBLE IN THE YEAR PAID UNDER CURRENT IRS REGULATIONS. WOULD YOU EXPLAIN WHAT THE PARAMETERS ARE UNDER CURRENT LAW, WHETHER CALLING THE CHARGE OF HOLDING FEE, A PENALTY, OR AN ADVANCE MINIMUM ROYALTY MAKES A DIFFERENCE, AND WOULD YOU ALSO EXPLAIN WHAT THE CURRENT ADMINISTRATION TAX PROPOSAL DOES TO THE CONSEQUENCES ON THE LEVEL OF THE HOLDING FEE?

Our understanding, as presented by the staff in its September 1985 analyses, is that a graduated fee of the sort proposed under S. 372 and S. 570 would not be deductible in the year paid. Specifically, we understand that in order for such a fee to be recognized as an expense in the year paid, for tax purposes, it must be characterized as a minimum royalty and the amount must be "substantially equal" over time. Therefore, a graduated fee would be deductible in the year credited, or capitalized in the year paid and subject to depletion once production commences. This would make the effect, on corporate decisionmaking, of the graduated fee virtually the same as if the fee assessed were a flat 1 percent in all years, rather than the stated graduated schedule which peaks at 1 percent in the 20th year. This is shown in Exhibit V-2 on p. 82 of the September 1985 staff report.

Although noncreditable fees may be treated, under current tax code, as a business expense in the year paid, and thus deductible in the year paid, it is not clear that this treatment would accrue to a fee characterized as a "penalty payment" for not attaining diligence. That is, the term "penalty" may disqualify the payment from normal cost recovery.

The implications of the different tax consequences on the level of the holding fees is shown in the September 1985 staff report, specifically Exhibit V-2 on p.82. That is, all analyses and effects on profitability are shown post-tax.

With respect to the current Administration tax proposal, the Treasury II proposal, our understanding is that the percentage (revenue) depletion would be phased out and that lease cost preceding production, including minimum royalty payments as well as rents, would have to be recovered via index cost depletion. This would be done in conjunction with the drop in the corporate tax rate from 46 percent to 33 percent. We are seeking confirmation of our interpretation from the Secretary of the Treasury and will request their assistance in analyzing the combined effects of the level of the holding fee and of its different tax treatment with lower tax rates. We are requesting comment from Treasury both with respect to our understanding of the current tax code and with respect to the implications, if any, of the Treasury II proposal. A copy of our request is attached. We will forward Treasury's response when we receive it.

3. WHAT IS THE DEPARTMENT'S CURRENT ESTIMATE OF AFFECTED LEASES?

The Staff analysis (summarized on Exhibit D-1 of its September 1985 report) indicates that an estimated 224 leases, representing 5.2 billion tons, will not be in compliance with section 2(a)(2)(A) on August 4, 1986.

3.(a) IN THE ABSENCE OF LEGISLATION, WHAT DO YOU FORESEE HAPPENING TO THESE LEASES? WILL THEY BE RELINQUISHED?

(a) Owing to a myriad of factors, on which the Department lacks information, we are unable to forecast, with any degree of accuracy, which or how many of these leases would be relinquished absent legislative change. Our information does, however, suggest that the company decision(s) to relinquish will, by-and-large, be independent of the development potential of the lease(s) and their economic readiness for development. The corporate decision(s) will most likely turn on whether or not the company (1) desires to acquire other Federal onshore mineral leases (e.g., oil and gas), and/or (2) whether the company anticipates a near-term need to acquire coal leases to maintain or expand production at operating mines. Thus the relinquishment decision, under current legislation, may well lead one company to relinquishment of those tracts that have the highest near-term development potential (including least adverse environmental consequences), while another company retains leases with lower near-term development potential and greater adverse environmental consequences, if these latter leases are held by companies who do not anticipate a near-term need for additional Federal onshore mineral leases.

4. IF CONGRESS WERE TO IMPOSE A FLAT HOLDING FEE OR MINIMUM ROYALTY IN LIEU OF PRODUCTION, IS THERE A REASON FOR LIMITING THE LEASE TERM?

If Congress were to impose a flat holding fee or minimum royalty in lieu of production the Department sees no reason for limiting the lease term. The reason for this is that it would be highly unlikely that any lessee would find it profitable to make the minimum royalty payment continuously from years 11 through 20 of the lease in the absence of some production income from that lease. This is because the cost of money, associated with making those payments, over such a period would sufficiently diminish profitability that the lessee would be unable to recover those costs, even with full crediting pursuant to production beginning after year 20. In the possible but unlikely circumstance that a lessee has entered production late in the term of the lease but has not produced sufficient reserves to qualify under the current diligence provision of 1 percent, the Department sees no benefit from forcing relinquishment of that lease, particularly if that lessee continues to be willing to make the minimum payments.

5. WOULD YOU PLEASE BRIEFLY OUTLINE THE DEPARTMENT'S GUIDELINES ON SECTIO 2(a)(2)(A)?

Section 2(a)(2)(A) guidelines clarify the lessee-qualification provision and its interrelationship with the other provisions of the Mineral Leasing Act of 1920 (MLA), as amended by the Federal Coal Leasing Amendments Act of 1976 (FCLAA). The guidelines are based on Solicitor's Opinion M-36951, dated February 12, 1985, interpreting Section 2(a)(2)(A).

Beginning on August 4, 1986, Section 2(a)(2)(A) will add another requirement to the existing requirements that must be met in order for a lessee to qualify to be issued any MLA leases. The guidelines establish how a lessee that holds a Federal coal lease(s) and has held it for at least 10 years can qualify under Section 2(a)(2)(A) by producing in commercial quantities simultaneously from all such leases or from anywhere within an LMU containing such leases. The current holder of a lease not producing in commercial quantities can end its prohibition by arm's-length assignment or relinquishment, and the producing obligation for a lease not assigned or relinquished may be suspended by FCLAA _force majeure_ (i.e., strikes, the elements or casualties not attributable to the lessee) or by Section 39 of MLA (in the interest of conservation) suspensions. For leases subject to FCLAA continued operation, the producing obligation may be suspended by payment of FCLAA advance royalty in lieu of continued operation.

The Section 2(a)(2)(A) guidelines address the three different uses of the term "commercial quantities" added to MLA by FCLAA and clarify the difference between the Section 2(a)(2)(A) "lessee-qualification" use of the term and the Section 7 "diligence" uses of the term. Guidance is provided to Bureau of Land Management (BLM) Field Offices to determine for producing leases the time period during which the Section 2(a)(2)(A) producing obligation (fixed by rule at 1 percent of the recoverable reserves) must occur for each pre-FCLAA lease; however, in no event can the time frame exceed 10 years. Flow charts and discussions are provided which detail when a Federal coal lease allows or disallows a lessee to qualify under Section 2(a)(2)(A) for any MLA lease to be issued on or after August 4, 1986. The guidelines discuss how the "holds and has held" provision applies to Congressionally authorized or mandated coal lease exchanges. The guidelines contain an in-depth discussion of how _force majeure_ suspensions, FCLAA advance royalty, Section 39 suspensions, assignments/reassignments, and relinquishments affect lessee qualifications under Section 2(a)(2)(A). The guidelines contain three appendices: definitions; a listing of MLA minerals prohibited from being leased to disqualified entities; and a discussion of affiliates. In summary, the purpose of the guidelines is to aid BLM Field Offices and lessees of MLA leases in determining compliance with the Section 2(a)(2)(A) lessee-qualification provision that will be effective for the first time on August 4, 1986.

6. YOUR ANALYSIS INDICATES THAT 10 YEARS IS NO LONGER A SUFFICIENT LEAD TIME FOR A LESSEE TO ACHIEVE PRODUCTION AND THAT 12-15 YEARS IS MORE REALISTIC. WOULD YOU EXPLAIN WHY AND ALSO INDICATE WHAT THE TIMEFRAMES ARE FOR THE INCREMENTAL DECISIONS SUCH AS APPROVAL OF PLANS?

As indicated by the staff analysis in the September 1985 report, it is not at all clear that 10 years is sufficient time for development under current circumstances. After acquiring a lease, a lessee must find a coal user, negotiate a satisfactory coal contract, obtain needed permits, and finally develop the mine and begin production. A reasonable time for these activities is likely greater than 10 years under current coal market conditions. Staff also noted that the early draft of the FCLAA allowed for a 15 year period prior to the requirement to produce from or else lose a lease. Moreover, it should be recognized that the 10 year diligence period currently embodied in MLA sections 2(a)(2)(A) and 7 was specified prior to passage of the Surface Mining Control and Reclamation Act, which has generally lengthened the predevelopment period. In these respects, we believe that 12 to 15 years would be a more realistic and reasonable diligence period. We are preparing an analysis that will indicate more precisely what a realistic timeframe would be. The Department will make that analysis available to you immediately upon its completion, anticipated to be the beginning of calendar year 1986.

7. IN THE TESTIMONY BEFORE THE LINOWES COMMISSION IN NOVEMBER, 1983, ASSISTANT ATTORNEY GENERAL WILLIAM F. BAXTER STATED:

> "BECAUSE THE ISSUANCE OF FEDERAL COAL LEASES TO MOST RAILROADS WOULD NOT RAISE SERIOUS COMPETITIVE CONCERNS, WE SEE NO REASON TO CONTINUE TO PROHIBIT RAILROADS IN GENERAL FROM ACQUIRING FEDERAL COAL LEASES. AS FOR THOSE FEW SITUATIONS IN WHICH ANTI-COMPETITIVE EFFECTS MAY BE POSSIBLE, THERE IS ALREADY A MECHANISM IN PLACE THAT ADEQUATELY PROTECTS COMPETITION."

THE MECHANISM HE WENT ON TO CITE WAS SECTION 15 OF THE FEDERAL COAL LEASING AMENDMENTS ACT OF 1976.

IN YOUR NOVEMBER 8, 1985 STATEMENT BEFORE THE COMMITTEE, YOU STATED THAT IF SECTION 15'S SAFEGUARDS PROVED INADEQUATE, OTHER SAFEGUARDS MAY BE NEEDED, INCLUDING A GENERAL PROHIBITION TO THE RAILROAD BIDDING ON ANY TRACT IN AN AREA WHERE THE AFFILIATED RAIL CARRIER HAS MARKET POWER OVER THE TRANSPORTATION OF COAL.

(a) DID THE SECRETARY OF THE INTERIOR TAKE THIS QUALIFIED POSITION IN RESPONSE TO THE LINOWES COMMISSION'S RECOMMENDATION ON 2(c)? IF NOT, WHAT HAS CAUSED YOU TO CHANGE YOUR POSITION?

(a) The change in the Administration position as noted in the Department's November 8 testimony, is in part in response to observations of the Linowes Commission. In particular, at p. 341, the Commission noted:

> To the extent that the railroad would limit their bidding to their own checkerboard areas, competition for individual leases is not likely to be much increased by the repeal of section 2(c). [Earlier the Commission noted that repeal of section 2(c) has been justified on the basis that railroads or their affiliates would enter bidding for Federal leases, thus, increasing competition.] For these tracts, the railroad advantage in assembling a logical mining unit would discourage other potential bidders. On tracts within the railroad checkerboard, repeal of section 2(c) may simply displace multiple bidders in favor of the railroad. Such tracts would become similar to captive Federal tracts that typically draw only one bid from the coal company holding adjacent coal. Bidding from railroads outside their checkerboard could of course increase competition for bidding for these Federal leases.

Consistent with its prior position, the Department believes there are potential benefits from the development of checkerboard lands, and that

7.(a) cont.

railroad participation is a definite factor in such development. A number of factors will influence the realization of these benefits, including:

- the extent of railroad participation in bidding for leases in non-checkerboard areas;
- the level of competition achieved in checkerboard auctions;
- any potential railroad advantage in the checkerboard area;
- the potential for monopoly abuse from vertically integrated entities;
- the potential for railroad acquisition of existing coal producers, which could tend to lessen competition; and
- the size, location, and timing of Federal coal lease auctions which are factors currently under the Department's control.

Moreover, the passage of the Staggers Rail Act of 1980 has certainly increased the complexity of the issue. In addition, the Department has noted that arguments in opposition to repeal of section 2(c), as well as arguments in favor of such action, have contained strong elements of emotional reaction and/or partial, incomplete analysis that may be largely speculative in nature. We reiterate that mandatory cooperative leasing, of the sort outlined by the Department in its November 8 statement as well as by the Linowes Commission, coupled with data sharing, go a long way toward developing a workable and hopefully acceptable compromise.

7.(b) WITH RESPECT TO ASSISTANT ATTORNEY GENERAL BAXTER'S NOVEMBER, 1983 STATEMENT, DO YOU HAVE ANY SPECIAL EXPERTISE IN THE DEPARTMENT OR ANY ADDITIONAL INFORMATION THAT WAS NOT AVAILABLE TO THE JUSTICE DEPARTMENT TWO YEARS AGO? IF NOT, WHAT LEADS YOU TO SUGGEST THAT OTHER SAFEGUARDS MAY BE NEEDED?

(b) We are now taking the opportunity to analyze information that was not available to the Justice Department, specifically the additional 2 years of data and market evolution since passage of the Stagger's Rail Act of 1980. The Department believes that sufficient concern has been raised by both coal producers and electric utilities during this period to warrant a detailed analysis of that situation, including patterns of pricing and competition that have developed, to determine whether or not additional safeguards may be needed. The Department is not stating, at this time, that additional safeguards are needed. Both the coal producers as well as the railroads have agreed to provide the Department assistance in reviewing this question so a position within the Administration on the need for additional safeguards can be resolved. These groups have indicated to staff that they will make available data, so an analysis can proceed in an expeditious manner. The staff indicates it expects to be able to report on the results of that analysis within the first quarter of calendar 1986.

8. IN YOUR NOVEMBER 8, 1985 STATEMENT, YOU CONTEND THAT MANDATORY COOPERATIVE LEASING SHOULD BE THE CONDITION FOR ALL RAILROAD LEASING IN ITS OWN CHECKERBOARD AREA AND CONCLUDE THAT IT WOULD BE UNNECESSARY AND INAPPROPRIATE TO REQUIRE THE SECRETARY TO MAKE A FINDING OF ENHANCED COMPETITION BEFORE IMPOSING COOPERATIVE LEASING AS A CONDITION TO THE RAILROAD'S PARTICIPATION IN THE LEASE SALE.

(a) WHY DO YOU BELIEVE THAT MANDATORY COOPERATIVE LEASING SHOULD BE A CONDITION FOR ALL RAILROAD LEASING IN CHECKERBOARD AREAS?

(a) The conclusion of the Linowes Commission (p.342) is that repeal or amendment of section 2(c) "should be linked with measures to ensure equal access by coal companies to coal in the checkerboard areas. This objective could be accomplished by requiring cooperative leasing of any Federal coal offered for lease in checkerboard areas (emphasis added)." This mandate we believe allows all parties equal access to the Federal coal, and is believed to represent a reasonable compromise between the several parties.

8.(b) DO YOU FEEL THAT AN INFLEXIBLE REQUIREMENT FOR COOPERATIVE LEASING THAT DOES NOT TAKE INTO ACCOUNT THE EXTENT AND NATURE OF THE INTERMINGLED OWNERSHIPS IN THE AREA, LOCAL AND REGIONAL MARKET CONDITIONS AND SIMILAR CONSIDERATIONS IS APPROPRIATE IN ALL CASES OF RAILROAD LEASING IN CHECKERBOARD AREAS?

(b) The Department believes its position favoring mandatory cooperative leasing does take into account almost all factors including the extent and nature of the intermingled ownership in the checkerboard area. Moreover, the same procedures would be followed with respect to leasing Federal tracts elsewhere, including the role for the Regional Coal Teams in determining the same and nature of the tracts. We believe this will assist in assuring full and consistent attention to local and regional market conditions, and similar considerations. The only area that we may have a concern is coal bypass situations at existing mines already in production. Another mine on State or private coal could develop similar concerns but we believe the facts of each case need to be reviewed and flexibility provided to assure bypass situations are minimized or prevented through establishement of LMU tracts prior to start up of production.

9. AMENDMENT 801 PROVIDES FOR A NUMBER OF EXCEPTIONS TO THE GENERAL REQUIREMENT THAT THE RAILROAD OR ITS MINING AFFILIATE AGREE TO COOPERATIVE LEASING AS A CONDITION TO PARTICIPATING IN FEDERAL LEASE SALES IN CHECKERBOARD AREA. YOUR STATEMENT OPPOSES ALL OF THE EXCEPTIONS.

(a) WITH RESPECT TO YOUR OBJECTION TO THE EXCEPTION WHERE THE RAILROAD OR ITS MINING AFFILIATE IS OPERATING A MINE ON THE ADJACENT PROPERTY AND ITS COAL IS ALREADY COMMITTED TO A PURCHASER PRIOR TO THE DATE OF ENACTMENT, HOW COULD A RAILROAD OR ITS MINING AFFILIATE AGREE TO COOPERATIVELY LEASING ITS COAL UNDER THESE CIRCUMSTANCES? WOULDN'T THAT NECESSARILY PRECLUDE DEVELOPMENT OF THE INTERMINGLED COAL, AS APPEARS TO BE THE CASE AT SF MINERALS' LEE RANCH MINE?

(a) To the extent that a railroad or its mining affiliate is operating a mine on adjacent property and its coal is already committed to a purchaser prior to the date of enactment of the suggested amendment, cooperative leasing would in no way preclude such railroad or its mining affiliate from being the successful bidder of an adjacent mining unit that would encompass both railroad and Federal tracts. Indeed, we believe that the railroad would have a significant incentive to compete vigorously for such a mining unit. Rather than precluding development of the intermingled coal, such an arrangement would appear to encourage such development and possibly competition. Cooperative leasing would in no way require that lands currently being developed by the railroad or its affiliate and committed to a purchaser be included in the aforementioned mining unit. We do not envision cooperative leasing as requiring the railroad affiliate to offer for lease tracts it currently holds in an active mine. With respect to adjacent tracts, access to which the affiliate may require to fulfill future commitments, flexibility is required so that they may be addressed on a case-by-case basis. That is, the immediacy of the need by the affiliate for such additional tracts must be weighed against the value to the public of including such tracts in a separate mining unit to be offered under cooperative leasing immediately or at some future time. The Department is also concerned that this practice does not lead to a situation of an incremental need approach to avoid the requirement for cooperative leasing.

By strictly adhering to such a condition, the Department seeks to avoid a situation in which a railroad or its mining affiliate, currently operating a mine, could extend its mine into railroad tracts to encircle three sides of an adjacent Federal tract thus, creating an orphan or bypass situation for the Federal tract which could be avoided by the formulation of a separate mining unit.

9.(b) WITH RESPECT TO YOUR OBJECTION TO THE EXCEPTION WHERE THE FEDERAL GOVERNMENT OWNS LESS THAN 35 PERCENT OF THE RESERVES IN A PROPOSED MINING UNIT, IS IT YOUR POSITION THAT THE DEPARTMENT SHOULD DICTATE THE TIMING AND NATURE OF DEVELOPMENT OF COAL IN ALL CHECKERBOARD AREAS, EVEN WHERE THE U.S. IS DISTINCTLY MINORITY OWNER? IF SO, WHY?.

(b) The Department would not dictate the timing and nature of development in a checkerboard mining unit that contains both Federal and railroad lands whether the Department is a minority or majority owner of the particular mining unit. Specifically, the mining unit would be configured pursuant to negotiation between the Secretary and the railroad and the unitized offering being put up for auction pursuant to those negotiations. Under this procedure, whether the Department holds a 35% undivided interest in the subsequent unit or a 65% undivided interest in the subsequent unit is of no consequence except for the division of royalty and rental revenues pursuant to sale.

To look at it differently, why should the rail affiliate dictate the timing when it is a distinctly minority owner? In the checkerboard, the two must act in concert in order to have cooperative leasing. If either is not interested, the other may lease its alternate sections, first, alone, with certain adverse consequences on the leasing of the later alternate sections and on development prospects for the area as a whole.

10. ON PAGE 21 OF YOUR TESTIMONY, YOU STATED THAT "INSTEAD OF FOLLOWING THE COOPERATIVE LEASING PROCEDURES REQUIRED BY THE PROPOSED AMENDMENT, WE FAVOR ADVANCE NEGOTIATION OF BID AND ROYALTY SHARES TO REDUCE UNCERTAINTY." PLEASE EXPLAIN HOW YOUR PROPOSAL DIFFERS FROM WHAT YOUR VIEW AS CONTEMPLATED BY AMENDMENT 801.

Our understanding of the procedure for cooperative leasing contemplated by amendment 801 is that the railroad, if not the successful bidder for a Federal lease, would offer for lease the land grant coal deposits owned by the railroad in the potential mining unit on reasonable terms which are mutually agreed to by the Secretary and the railroad, but such terms may differ from the terms of the Federal lease. Such a situation may well result in a less competitive situation owing to uncertainty and non-uniformity of terms across the mining unit. The Department's proposal for cooperative leasing, consistent with the recommendation of the Linowes Commission, would operate as follows:

o The Secretary and the railroad jointly determine which Federal and railroad lands shall comprise the mining unit to be offered.

o Based on the quality and quantity of reserves on the railroad lands and Federal lands of the mining unit, the Secretary and the railroad would negotiate respective percentage shares of such unit, as though such percentage shares represent an undivided interest of both parties in the mining unit.

o Both the Federal Government and the railroad simultaneously offers the mining unit at auction in the same manner, and using the same procedures to assure receipt of fair market value, as would be the case if the mining unit were a single Federal tract.

o Assuming the unit is sold at auction, it would be developed consistent with prevailing Federal legislation and regulations, with disbursement of income from the unit to the Treasury and to the railroad affiliate according to the previously negotiated shares of the project.

o In the event the mining unit fails to draw a bid consistent with the Department's presale appraisal of fair market value, and no lease is issued, the mining unit would revert back to the individual tracts as was the situation prior to commencement of negotiations.

11. PLEASE EXPLAIN YOUR ALTERNATIVE PROCEDURE PROPOSED ON PAGES 21-22 FOR MAKING AVAILABLE DATA ON COAL OWNED BY RAILROAD AFFILIATES IN CHECKERBOARD AREAS.

Amendment 801 provides that "upon request [the railroad] make available at reasonable costs to any potential bidder for the Federal lease any and all exploration data in the possession of the company concerning the extent and the nature of the land grant coal within the potential mining unit." In order to head off potential problems and disagreements relative to what cost shall be considered "reasonable," the Department recommends that the legislation also provide some guidance as to what would constitute "reasonable cost." In addition, the Department would, under its concept of cooperative leasing and acting as agent for both the railroad and the Federal Government, allow all potential bidders physical access to the negotiated mining unit to obtain necessary geological data directly from that unit, either in lieu of or in addition to data purchased from the railroad directly.

12. YOUR NOVEMBER 8, 1985, STATEMENT OPPOSES THE PROVISIONS OF AMENDMENT 801 PROVIDING FOR THE DISCLOSURE OF COAL SUPPLY AND TRANSPORTATION CONTRACTS TO COMPLAINING COAL PRODUCERS THROUGH THE SECRETARY OF INTERIOR. YOU HAVE THREE OBJECTIONS TO THESE PROVISIONS.

(a) WITH RESPECT TO YOUR FIRST OBJECTION, THAT THE DEPARTMENT LACKS EXPERTISE IN REVIEWING TRANSPORTATION CONTRACTS, WHAT SORT OF EXPERTISE WOULD BE NEEDED TO SIMPLY COMPARE SUCH CONTRACTS TO DETERMINE WHETHER THEY ARE "SUBSTANTIALLY IDENTICAL IN ALL MATERIAL RESPECTS" BEFORE RELEASING THEM TO THE COMPLAINING COAL PRODUCER, AS PROVIDED IN AMENDMENT 801?

It is the Department's understanding that transportation contracts may be unique with respect to rates charged, services and/or equipment provided and other related matters that would make it difficult to determine whether such contracts are "substantially identical in all material respects." The Department has never had the responsibility for reviewing railroad service conditions, analyzing the complex terms in transportation contracts, or in determining what allowances may or may not be appropriate even for such basic factors as cost differences for railroad or utility owned cars, short-haul versus long-haul runs, and single line versus multi-line rates. Moreover, the Department is not sufficiently familiar with the Staggers Act to know under what conditions it could release such contracts to a complaining coal producer, if it could at all, particularly given that such contracts would most likely be between the railroad or railroads and the utility as shipper. Such a responsibility would undoubtedly require significant additional training of Department personnel as well as increases in its authorized staffing level.

12(b) WITH RESPECT TO YOUR SECOND OBJECTION, THAT THE DISCLOSURE REQUIREMENT MAY DUPLICATE EFFORTS CURRENTLY PERFORMED BY THE INTERSTATE COMMERCE COMMISSION, PLEASE ELABORATE ON HOW SUCH A DUPLICATION WOULD OCCUR.

With respect to the expertise required as indicated in the answer to part (a) of this question, the Department understands that such expertise and capability currently exist at the Interstate Commerce Commission. Thus, any increase in staffing and training of Department staff would largely duplicate the capabilities currently at the Interstate Commerce Commission. Moreover, reviewing and monitoring the transportation contracts would duplicate the review which we believe the Interstate Commerce Commission may already be performing pursuant to its responsibilities under the Staggers Rail Act of 1980.

12.(c) WITH RESPECT TO YOUR THIRD OBJECTION, THAT "PUBLIC DISCLOSURE" COULD LEAD TO ANTI-COMPETITIVE PRICING, PLEASE EXPLAIN HOW THIS COULD OCCUR, GIVEN THE LIMITATIONS THE AMENDMENT PLACES ON THE SCOPE OF DISCLOSURE AND THE USE OF THE INFORMATION DISCLOSED.

The Department does not believe that the sort of public disclosure of contract information as contemplated in Amendment 801 could lead to any sort of anti-competitive pricing. On the contrary, the Department is unable to determine how such release of such basic market information could do anything other than further foster a competitive environment. However, the Department is not an expert with respect to the provisions of the Staggers Act, and other branches of the Executive Department (the Department of Justice and Office of Management and Budget have advised us of their belief that such action could be anti-competitive.)

13. IF RAILROAD MINING AFFILIATES ARE ONLY PERMITTED TO OBTAIN FEDERAL COAL LEASES OUTSIDE THEIR CHECKERBOARD AREA, WHY DO THEY NEED TO SUPPLY TRANSPORTATION RATE INFORMATION TO THE SECRETARY OR THE PUBLIC?

As indicated in its November 8 statement, the Department believes no restrictions are appropriate should a railroad or its mining affiliate desire to obtain Federal coal leases outside of its checkerboard area and/or outside of the coal producing area in which it provides monopoly transportation service.

14. SECTION 3 OF FCLAA STATES:

> "2(A) THE SECRETARY SHALL NOT ISSUE A LEASE OR LEASES UNDER THE TERMS OF THIS ACT TO ANY PERSON, ASSOCIATION, CORPORATION, OR ANY SUBSIDIARY, AFFILIATE, OR PERSONS CONTROLLED BY OR UNDER COMMON CONTROL WITH SUCH PERSON, ASSOCIATION, OR CORPORATION, WHERE ANY SUCH ENTITY HOLDS A LEASE OR LEASES ISSUED BY THE UNITED STATES TO COAL DEPOSITS AND HAS HELD SUCH LEASE OR LEASES FOR A PERIOD OF TEN YEARS. . . ."

WOULD THE DEPARTMENT PLEASE FURNISH FOR THE RECORD THE DEFINITION OF "CONTROL" AS USED IN SECTION 3?

The language of Section 2(a)(2)(A) of MLA and the legislative history of Section 11 of FCLAA suggest the "control" is the key concept through which ownership of a Federal coal lease will be attributed to related corporate entities. The phrase "controlled by or under common control with such person, association, or corporation" modifies the words "subsidiary," "affiliate," and "persons." Therefore, when a chain of corporate ownership is involved, the question is whether a given corporation is "controlled by or under common control with" a related corporation. If there is sufficient control of a corporation by another corporation, related corporations in the corporate chain will be charged with ownership of the Federal coal lease.

Generally, legal control will be found whenever a parent corporation owns 50 percent or more of a subsidiary or affiliate. Actual control may exist where a corporation owns less than 50 percent or where stock ownership is widely dispersed. The question of whether a particular entity is "controlled by or under common control with" another entity for Section 2(a)(2)(A) purposes will have to be determined on a case-by-case basis at the time that qualifications are being determined for a Federal lease issuance on or after August 4, 1986. The concept of control will be developed primarily through administrative adjudication. We are continuing to consider whether additional guidelines or regulations are needed to aid in adjudication.

United States Department of the Interior

OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20240

DEC 20 1985

Assistant Secretary-Tax Policy
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Dear Sir:

The Congress is currently considering legislation to amend the Mineral Lands Leasing Act of 1920 regarding Federal coal. The Department of the Interior, as the manager of Federal coal, recently testified concerning these proposed amendments. In the most recent testimony before the Senate Subcommittee on Natural Resources Development and Production, questions were raised which dealt with the tax treatment of advance royalties paid by coal lessees. Those questions raised some difficult issues which need further analysis. We believe that this analysis should incorporate the expertise of the Treasury Department on tax matters, and we solicit your aid and assistance. Specifically, these questions relate to the current conditions under which an advance royalty, creditable against future production royalties, may be expensed, for tax purposes, in the year paid; whether penalty payments may be expensed; and transferability of advance royalty credits. Finally, to what extent would these conditions change, if at all, under the Treasury II tax proposal?

Advance Royalties

We understand that the Internal Revenue Service does consider non-creditable advance royalty payments to be a deductible business expense in the years paid, but creditable advance royalty payments are deductible when paid only if the payment is characterized as a minimum royalty and the minimum royalty amounts are "substantially equal" over time including those years in which production royalties are also payable. What determines whether or not an advance royalty is "substantially uniform" overtime? Could we consider that a payment was "substantially equal" over time if it were a constant fraction of price, and price changed no more frequently than annually?

Penalty Payments

How would a non-creditable "penalty" payment for not attaining diligence be treated? Does the term "penalty" disqualify the payment from recognition for tax purposes?

Transferability

What are the implications and elections, if any, if the rights to the uncredited portion of creditable advance royalties previously paid (the "bank") are transferred to a third party, in an arm's-length transaction, along with the lease development rights? Our understanding of the current tax code is that the assignee would deduct the full nominal value of the bank from the acquisition price to determine the net value of the depletable asset. We also understand that, if the assignor has expensed these payments for tax purpose in the past that the assignee would not be permitted to expense them unless the assignor "reversed its prior expensing," effectively paying back its tax benefits. Under the latter situation, the assignor would be permitted to expense the nominal value of the bank in the year paid. Is our understanding correct? In addition, in the event the total acquisition price of the leasehold asset and the bank was less than the nominal value of the bank, would the depletable asset base be negative or constrained to be zero? In the event it would be negative, how would the depletion work?

Treasury II Implications

What changes, relative to the above, would result from the Treasury II proposals. Our understanding is that percentage (revenue) depletion would be phased out and that lease costs preceding production would have to be recovered via indexed cost depletion. This would be done in conjunction with a drop in the corporate tax rate from 46 percent to 33 percent. These are the principle changes that are relevant to the issue of advance royalties. Are these interpretations correct? What effect would this have on the assignment issue? In particular, what would be the implications or treatment of a bank, a portion of which having been established under the current rules and a portion established pursuant to passage of Treasury II? Would credit from the bank be done on a LIFO, FIFO, or proportional basis, or would this be an election?

The Department of the Interior desires to revise its analysis under existing tax laws to take account of the proposed changes under Treasury II. This is necessary both to provide a full and complete response to the Congress, as well as to determine what changes, if any, in our recommendations would be appropriate to the tax climate under Treasury II. Could you provide assistance to our analytical staff in this area? Please contact Erick Kaarlela or John Broderick within the Bureau of Land Management at 343-5517.

We appreciate your assistance on this important matter.

Sincerely,

J Steven Griles
Assistant Secretary-Land and
Minerals Management

QUESTIONS SUBMITTED BY SENATOR JOHNSTON

1. HOW MANY NONPRODUCING PRE-1976 COAL LEASES HAVE BEEN RELINQUISHED ANNUALLY SINCE THE ENACTMENT OF THE FEDERAL COAL LEASING AMENDMENTS ACT OF 1976 ("FCLAA")?

Between August 4, 1976, and October 30, 1985, there were 39 leases that ceased to exist for various reasons: One lease was exchanged because of the Bisti Exchange authorized by Congress; one lease was exchanged because of the I-90 Exchange authorized by Congress; three leases were transferred to the State of Utah via in-lieu selection; three leases in Wyoming were consolidated with existing, adjacent leases; three pre-1976 leases were totally mined out and reclaimed and subsequently relinquished; and one lease was issued in 1984 and relinquished in 1985. The remaining 27 pre-1976 leases were relinquished without having had prior production.

By year and BLM State Office, those 27 remaining leases are summarized below.

	BLM STATE OFFICE						
YEAR	ES*	UT	NM	WY	CO	MT	TOTAL
8/4/76 - 12/31/76	0	0	0	0	0	0	0
1977	0	1	0	0	0	0	1
1978	0	0	0	0	0	0	0
1979	0	0	0	0	0	0	0
1980	0	0	0	0	1	0	1
1981	0	0	1	1	0	0	2
1982	0	0	0	0	0	0	0
1983	0	0	1	4	5	0	10
1984	0	2	1	2	0	1	6
1/1/85 - 10/31/85	1	0	4	2	0	0	7
TOTAL	1	3	7	9	6	1	27

*Eastern States

2. BLM'S ANALYSIS OF OPTIONS FOR AMENDING THE MINERAL LEASING ACT SECTION 2(a)(2)(A) AND 7, PUBLISHED IN SEPTEMBER, 1985, STATES THAT THERE ARE 224 NONCOMPLIANCE PRE-1976 FEDERAL COAL LEASES. IS THAT FIGURE CURRENT AS OF SEPTEMBER, 1985? IS ANY MORE RECENT DATA AVAILABLE?

As we noted in that publication, there were a number of qualifications to the estimated statistic. The number 224 was a current estimate as of a couple of months prior to September, and was meant to be illustrative of the general magnitude. We have not made a more recent estimate of noncompliance leases.

3. HOW MANY ASSIGNMENTS OF FEDERAL COAL LEASES HAVE OCCURRED EACH YEAR SINCE 1976?

We do not keep this historical data at our Washington headquarters office. That data is maintained in our field offices. We do not have the information readily available, but we are assembling it now and will forward it to you when we complete the compilation. However, in July 1985, we conducted a study of just those Federal coal lease assignments pending on January 1, 1985, or submitted for approval between January 1, 1985, and July 31, 1985. Of the 71 pending or submitted requests for approval of Federal coal lease assignments, 55 were between wholly owned subsidiaries/affiliates and two were for Federal coal leases that are not yet 10 years old. The following pages contain a tabulation of those 71 requests for approval of assignments. Since most assignment requests to date appear to have been for internal corporate structural purposes, we believe that the tabulation is indicative of what the in-depth analysis of all Federal coal lease assignments since August 4, 1976, which we are conducting, would show.

Of the 71 pending or submitted for approval in that 7-month period alone, we believe that no more than 14 could be related to the Section 2(a)(2)(A) lessee-qualification prohibition. However, without direct communication with the entities involved for information that the entities may not desire to divulge, that may not be an accurate statement.

Please also see our response to question 5, regarding monitoring of arm's-length assignments.

Johnston #3

FEDERAL COAL LEASE ASSIGNMENTS [Pending on or Submitted on or after January 1, 1985]

STATE		Lease Number	Date Issued	Last Readj.	Assign. Filed	Assignor	Assignee	Status
New Mexico		sf074673	01/10/41	12/01/81	*	Robert Lee Davis	Leonard Wood	Pending
		Cannot furnish bond; still performing reclamation work; when reclamation complete, bond amount will be lowered, assignee will pay, and BLM will act on assignment.						
		nm2457	09/15/67	---------	*	Thermal Energy Co. & Peabody Coal Co.	Chaco Energy Co.	01/01/85
		nm10931	01/01/70	---------	*	Eastern Assoc. Prop. & Fannin Square Corp.	Meadows Resources	07/01/85
		nm28093	04/01/80	---------	*	Paragon Resources & Valencia Energy Co.	San Juan Coal Co.	04/01/85
		nm0186612	08/01/61	12/01/81	*	Valencia Energy Co.	Rincon Resources	01/01/85
		Valencia assigned 100 percent of its 50 percent interest in the lease. Paragon still retains 100 percent of its 50 percent interest in the lease.						
		nm0186613	08/01/61	12/01/81	*	Valencia Energy Co.	Rincon Resources	Closed out 01/23/85
		Valencia wished to assign 100 percent of its 50 percent interest in the lease. Paragon would have retained 100 percent of its 50 percent interest in the lease. Closed out due to Bisti Exchange (i.e., lease relinquished on 09/27/84 for nm45183) [see below]						
		nm0186615	08/01/61	12/01/81	*	Valencia Energy Co.	Rincon Resources	01/01/85
		Valencia assigned 100 percent of its 50 percent interest in the lease. Paragon still retains 100 percent of its 50 percent interest in the lease.						
		nm45183	09/27/84	---------	*	Valencia Energy Co.	Rincon Resources	01/01/85
		Valencia assigned 100 percent of its 50 percent interest in the lease. Paragon still retains 100 percent of its 50 percent interest in the lease.						
Oklahoma		blmc022999	06/01/62	06/01/82	*	Garland Coal & Mining	Bay Petroleum	04/01/85
Wyoming	@	w0220486	04/01/67	---------	03/20/85	Peabody Coal Co.	Peabody Holding Co.	05/01/85
	@	w0313667	10/01/65	---------	01/07/85	Peabody Coal Co.	Peabody Holding Co.	04/01/85
	@	w3438	03/01/70	---------	03/20/85	Peabody Coal Co.	Peabody Holding Co.	05/01/85

*Assignments pending on January 1, 1985

@Wholly owned subsidiary assignment/reassignment

405

405

Johnston #3

STATE		Lease Number	Date Issued	Last Readj.	Assign. Filed	Assignor	Assignee	Status
Wyoming (cont'd.)	@	w8385	03/01/71	---------	*	Sunoco Energy Development Co.	Sunedco Coal Co.	07/01/85
	@	w71692	12/01/66	---------	02/28/85	Shell Oil Co.	Shell Mining Co.	06/01/85
Colorado	@	c081330	11/01/63	---------	*	Colorado Yampa Coal Company (CYCC)	Getty Coal Company (GCC)	05/01/85
	@	c081330			*	GCC	Getty Minerals Marketing, Inc. (GMMI)	05/01/85
	@	c16284	07/01/78	---------	*	CYCC	GCC	05/01/85
	@	c16284			*	GCC	GMMI	05/01/85
	@	c20900	11/01/78	---------	*	CYCC	GCC	05/01/85
	@	c20900			*	GCC	GMMI	05/01/85
	@	c22644	07/01/79	---------	*	CYCC	GCC	Pending
	@	c22644			*	GCC	GMMI	Pending
		Pending due to pendency of royalty reduction request						
	@	c22676	09/01/79	---------	*	CYCC	GCC	05/01/85
	@	c22676			*	GCC	GMMI	05/01/85
	@	c0128433	06/01/75	---------	*	CYCC	GCC	Pending
	@	c0128433			*	GCC	GMMI	Pending
		Pending due to pendency of election to be subject to the 1982 regulatory diligence system and pending LMU application.						
		c20740	10/01/58	---------	*	Pitkin Iron Corp.	Powderhorn Prop's.	Pending
	@	d052547	03/01/45	03/01/65	*	CYCC	GCC	05/01/85
	@	d052547			*	GCC	GMMI	05/01/85
	@	c29220	08/01/81	---------	*	CYCC	GCC	05/01/85
	@	c29220			*	GCC	GMMI	05/01/85

*Assignments pending on January 1, 1985

@Wholly owned subsidiary assignment/reassignment

BLANK PAGE

BLANK PAGE

BLANK PAGE

STATE	Lease Number	Date Issued	Last Readj.	Assign. Filed	Assignor	Assignee	Status
Colorado (cont'd.) §	c813	04/01/70	---------	*	Utah International	General Electric	Pending
	Pending due to awaiting bond. Should be approved within 1 month. [Trapper Mining Inc.]						
§	c079641	10/01/62	---------	*	Utah International	General Electric	Pending
	Pending due to awaiting bond. Should be approved within 1 month. [Trapper Mining Inc.]						
§	c25948	06/01/80	---------	*	Utah International	General Electric	Pending
	Pending due to awaiting bond. Should be approved within 1 month. [Trapper Mining Inc.]						
§	c07518	06/01/58	---------	*	Utah International	General Electric	Pending
	Pending due to awaiting bond. Should be approved within 1 month. [Trapper Mining Inc.]						
§	c07519	06/01/58	---------	*	Utah International	General Electric	Pending
	Pending due to awaiting bond. Should be approved within 1 month. [Trapper Mining Inc.]						
§	c1362	09/01/67	---------	*	Atlantic Richfield	West Elk Coal Co.	Pending
§	d044569	08/30/34	08/30/74	*	Atlantic Richfield	West Elk Coal Co.	Pending
§	c0117192	06/01/65	---------	*	Atlantic Richfield	West Elk Coal Co.	Pending
§[Common Heirs]	d043937	04/05/32	03/01/80	*	Evelyn Welch and Shirley Wiggins	Helen C. Eldridge	03/01/85
	c069962	04/01/62	07/01/83	*	Henry and Opal Weaver	Sylvia McCormick	Pending
	Will be denied due to outstanding royalty/rental account.						
§	c083199	07/01/63	09/01/83	01/28/85	Peabody Coal Co.	Peabody Development	Pending
§	c086654	07/01/63	09/01/83	01/28/85	Peabody Coal Co.	Peabody Development	Pending
	c0117192	06/01/65	---------	06/13/85	Atlantic Richfield	Bear Coal Company	Pending
	Assignment is 100 percent, divided interest; new lease number to be assigned to acreage carved out from original lease, the remainder of which will still be held by Atlantic Richfield.						

---

*Assignments pending on January 1, 1985
§Wholly owned subsidiary assignment/reassignment

Johnston #3

STATE	Lease Number	Date Issued	Last Readj.	Assign. Filed	Assignor	Assignee	Status
Utah	u0147570	05/01/66	--------	*	Coastal States Energy Company	Getty Mineral Resources Co.	Pending
@	u13097	05/01/74	--------	*	Getty Mining Co.	GMMI	Pending
@	s1064903	01/24/46	01/24/66	*	Beaver Creek Coal Co.	Atlantic Richfield	02/12/85
@	s1064903			*	Atlantic Richfield	Beaver Creek Coal	02/12/85
	Atlantic Richfield wished to reassign to Bohn Lake Inc. (a wholly owned subsidiary, renamed from Beaver Creek Coal Co.). However, before BLM approved the assignments, Bohn Lake Inc. renamed itself Beaver Creek Coal Co.						
@	u020668	05/01/58	--------	*	Beaver Creek Coal Co.	Atlantic Richfield	02/12/85
@	u020668			*	Atlantic Richfield	Beaver Creek Coal	02/12/85
	Atlantic Richfield wished to reassign to Bohn Lake Inc. (a wholly owned subsidiary, renamed from Beaver Creek Coal Co.). However, before BLM approved the assignments, Bohn Lake Inc. renamed itself Beaver Creek Coal Co.						
@	u33454	12/01/78	--------	*	Beaver Creek Coal Co.	Atlantic Richfield	02/12/85
@	u33454			*	Atlantic Richfield	Beaver Creek Coal	02/12/85
	Atlantic Richfield wished to reassign to Bohn Lake Inc. (a wholly owned subsidiary, renamed from Beaver Creek Coal Co.). However, before BLM approved the assignments, Bohn Lake Inc. renamed itself Beaver Creek Coal Co.						
@	u38727	05/01/58	--------	*	Beaver Creek Coal Co.	Atlantic Richfield	02/12/85
@	u38727			*	Atlantic Richfield	Beaver Creek Coal	02/12/85
	Atlantic Richfield wished to reassign to Bohn Lake Inc. (a wholly owned subsidiary, renamed from Beaver Creek Coal Co.). However, before BLM approved the assignments, Bohn Lake Inc. renamed itself Beaver Creek Coal Co.						
@	u8319	03/01/70	--------	*	Beaver Creek Coal Co.	Atlantic Richfield	07/19/85
@	u8319			*	Atlantic Richfield	Beaver Creek Coal	07/19/85
	Atlantic Richfield wished to reassign to Bohn Lake Inc. (a wholly owned subsidiary, renamed from Beaver Creek Coal Co.). However, before BLM approved the assignments, Bohn Lake Inc. renamed itself Beaver Creek Coal Co.						

---

*Assignments pending on January 1, 1985

@Wholly owned subsidiary assignment/reassignment

STATE		Lease Number	Date Issued	Last Readj.	Assign. Filed	Assignor	Assignee	Status
Utah (cont'd.)	§	u53159	12/01/81	--------	*	Beaver Creek Coal Co.	Atlantic Richfield	02/12/85
	§	u53159			*	Atlantic Richfield	Beaver Creek Coal	02/12/85
		Atlantic Richfield wished to reassign to Bohn Lake Inc. (a wholly owned subsidiary, renamed from Beaver Creek Coal Co.). However, before BLM approved the assignments, Bohn Lake Inc. renamed itself Beaver Creek Coal Co.						
		s1036407	09/10/26	10/01/66	*	Lloyd, Lee, and Aliza Wilberg	J. O. Kingston	01/16/85
	§	u096476	03/01/67	--------	01/07/85	Peabody Coal Co.	Peabody Holding Co.	07/16/85
	§	u096477	03/01/67	--------	01/07/85	Peabody Coal Co.	Peabody Holding Co.	07/16/85
	§	u098786	03/01/67	--------	01/07/85	Peabody Coal Co.	Peabody Holding Co.	07/16/85
	§	u0101140	04/01/67	--------	01/07/85	Peabody Coal Co.	Peabody Holding Co.	07/16/85
	§	u0101141	04/01/67	--------	01/07/85	Peabody Coal Co.	Peabody Holding Co.	07/16/85
	§	u0103108	03/01/67	--------	01/07/85	Peabody Coal Co.	Peabody Holding Co.	07/16/85
	§	u0103131	04/01/67	--------	01/07/85	Peabody Coal Co.	Peabody Holding Co.	07/16/85
	§	u0103132	04/01/67	--------	01/07/85	Peabody Coal Co.	Peabody Holding Co.	07/16/85
	§	u0103133	04/01/67	--------	01/07/85	Peabody Coal Co.	Peabody Holding Co.	07/16/85
	§	u0113254	08/01/67	--------	01/07/85	Peabody Coal Co.	Peabody Holding Co.	07/16/85
	§	u0115656	11/01/67	--------	01/07/85	Peabody Coal Co.	Peabody Holding Co.	07/16/85
	§	u0115657	11/01/67	--------	01/07/85	Peabody Coal Co.	Peabody Holding Co.	07/16/85
	§	s1046612	04/02/29	04/07/70	07/03/85	Kaiser Steel Corp.	Kaiser Coal Corp.	Pending
	§	s1062966	11/12/43	11/12/83	07/03/85	Kaiser Steel Corp.	Kaiser Coal Corp.	Pending

*Assignments pending on January 1, 1985

§Wholly owned subsidiary assignment/reassignment

409

Johnston #3

STATE	Lease Number	Date Issued	Last Readj.	Assign. Filed	Assignor	Assignee	Status
Utah (cont'd.) @	s1066145	06/19/46	06/27/66	07/03/85	Kaiser Steel Corp.	Kaiser Coal Corp.	Pending
@	s1066490	12/31/47	03/12/68	07/03/85	Kaiser Steel Corp.	Kaiser Coal Corp.	Pending
@	s1068754	06/01/51	--------	07/03/85	Kaiser Steel Corp.	Kaiser Coal Corp.	Pending
@	s1069291	04/01/50	04/01/70	07/03/85	Kaiser Steel Corp.	Kaiser Coal Corp.	Pending
@	u02785	07/01/52	07/01/72	07/03/85	Kaiser Steel Corp.	Kaiser Coal Corp.	Pending
@	u014217	02/01/55	02/01/75	07/03/85	Kaiser Steel Corp.	Kaiser Coal Corp.	Pending
@	u014218	02/01/55	02/01/75	07/03/85	Kaiser Steel Corp.	Kaiser Coal Corp.	Pending
@	u039706	07/01/60	--------	07/03/85	Kaiser Steel Corp.	Kaiser Coal Corp.	Pending
@	u0126947	12/01/63	12/01/83	07/03/85	Kaiser Steel Corp.	Kaiser Coal Corp.	Pending
@	u0126948	12/01/63	12/01/83	07/03/85	Kaiser Steel Corp.	Kaiser Coal Corp.	Pending
@	u32083	03/01/79	--------	07/03/85	Kaiser Steel Corp.	Kaiser Coal Corp.	Pending
Montana	m052647	11/01/61	11/01/82	*	Divide Coal Co.	Storm King	Will Be Denied
	State of Montana shut them down--insufficient bond, no reclamation fees being paid, not paying royalty.						

*Assignments pending on January 1, 1985
@Wholly owned subsidiary assignment/reassignment

4. HAS THERE BEEN ANY EVIDENCE OF LESSEES ATTEMPTING TO "SWAP" NONCOMPLYING LEASES TO CIRCUMVENT THE MINERAL LANDS LEASING ACT ("MLA") SECTION 2(a)(2)(A) DILIGENCE REQUIREMENT?

To the best of our knowledge, there has been no evidence of lessees attempting to "swap" noncomplying leases to circumvent the MLA, section 2(a)(2)(A).

5. WHAT STEPS HAS BLM TAKEN TO ENSURE THAT ASSIGNMENTS ARE ARM'S-LENGTH?

While there is no language in the MLA barring other-than-arm's-length assignments from occurring, the existing regulations (43 CFR 3453.3-1(a)(8) and 3472.1-2(e) (1984)) prohibit assignment of a Federal coal lease to a Federal coal lessee, or any affiliate, on or after August 4, 1986, if that lessee, or any affiliate, does not meet the lessee-qualification provisions of Section 2(a)(2)(A) of MLA. These regulations apply regardless of whether the assignment is arm's-length.

Beginning on August 4, 1986, BLM will ensure compliance with the above-cited regulations to determine lessee-qualification before an assignment may occur. Data supplied to BLM, as part of the assignment documentation pursuant to 43 CFR 3453.2-2, will be sufficient to determine whether the assignment is arm's-length (this applies to all Federal coal lease assignments that have occurred since August 4, 1976). The data will then be used in determining lessee-qualifications at the time of subsequent assignment requests on or after August 4, 1986.

6 I UNDERSTAND THAT THE DEPARTMENT'S DRAFT OF SUGGESTED CHANGES TO THE AMENDMENT TO H.R. 1934 CONTAINS A SECTION PROVIDING THAT SECTION 2(a)(2)(A) DILIGENCE REQUIREMENTS WILL APPLY PROSPECTIVELY TO NONCOMPLYING PRE-1976 LEASES ACQUIRED BY ASSIGNMENTS. PLEASE DESCRIBE HOW THE DEPARTMENT WOULD IMPLEMENT THIS PROVISION. TO WHAT LEASES WOULD IT APPLY?

The FCLAA has prescribed separate "clocks" for sections 2(a)(2)(A) and 7. In particular, the section 2(a)(2)(A) clock is reset with each arm's-length assignment. Since the Department believes that sections 2(a)(2)(A) and 7 both address the same basic issue (that of a diligence/anti-speculation policy) there is no necessity for separate clocks. Indeed, the existence of two clocks introduces an additional complexity for implementation. Accordingly, it is the Department's desire, assuming our recommended minimum royalty approach to diligence is adopted, that the notion of the two clocks be dropped. Specifically, after the passage of the subject legislation an arm's-length assignment would no longer reset a new 10-year section 2(a)(2)(A) clock for the assignee. Rather, the minimum royalty obligation would simply apply to each "old" lease as soon as possible, and the assignment of an "old" lease subject to the new minimal royalty obligation would not alter the applicability of that new lease obligation to the assignee. This would apply to all leases and is consistent with the notion of a single diligence/anti-speculation policy.

7. S. 372 WOULD ALLOW LESSEES HOLDING ONLY ONE OR TWO NONCOMPLIANCE LEASES TO ACQUIRE NEW FEDERAL COAL LEASES UPON THE PAYMENT OF HIGHER RENT ON THE NEW COAL DEPOSITS.

   - WHAT IS THE DEPARTMENT'S VIEW ON THIS PROPOSAL?

   - HOW MANY LESSEES HOLD ONLY ONE OR TWO NONCOMPLIANCE LEASES?

Upon initial inspection the payment of a higher rent on the new coal deposits in the event the lessee holds a noncompliance lease would appear to offer a reasonable solution to the problems resulting from the current legislation in that lessees would have more flexibility for determining when to begin development; could continue to obtain additional leases while still holding older noncomplying leases; and the public could be expected to receive additional lease revenues. However, the Department believes that the approach has several shortcomings that prevent it from providing a comprehensive solution to the problem of MLA sections 2(a)(2)(A) and 7. In particular, as noted on p.58 of the staff analysis, diligence is encouraged only insofar as a lessee holding noncomplying leases wishes to obtain new leases. In the extreme, if a lessee has no interest in obtaining additional leases then this approach would provide no diligence incentive at all. That is to say, there would be no encouragement for such lessee to either develop the leases that it currently holds, or relinquish those leases that it does not reasonably expect to develop in the near future. In addition, even if a lessee wishes to obtain a new lease, the strength of the diligence incentive is not stable, but would vary with the quantity of acreage or reserves obtained in the new leases. Accordingly, this approach does not satisfy the criteria of providing a stable and consistent policy signal.

Another problem with this approach is that it may not provide a share of speculative gains to the public. Specifically, because a lessee knows with certainty that it will face additional lease payments if it acquires new leases or continues to hold noncomplying leases, the lessee would be encouraged to reduce its bonus bids to offset these payments as it competes for the new leases. To the extent that lessees who may compete for a tract would be subject to the same additional lease payments, the reduction of bonus bids to offset the additional payments will not reduce the lessees' competitiveness as they compete against each other for the tract. In effect, the lessees would suffer no penalties from the fee either as additional outlays or as reduced abilities to compete for leases. The implication of this result for public policy is that the public will really receive no additional revenue payments (i.e., the increase in rental or other downstream payments will be offset by reduced bonuses and the public will not share in speculative gains that may occur on the noncomplying tracts.)

Of the 81 entities currently holding noncomplying coal leases 63, or 78%, hold two noncomplying leases or less. Of this number, 54 hold only 1 noncomplying lease. Please note that this number is the number of registered lessees and does not consider whether or not a lessee holds more than two noncomplying leases by reason of affiliation or other organization under common control with other lessees who may also hold noncomplying leases.

8. S. 372 AND S. 570 BOTH AMEND SECTION 7 OF THE MLA TO ALLOW LESSEES TO CONTINUE TO HOLD NONPRODUCING LEASES FOR UP TO TWENTY YEARS UPON THE PAYMENT OF AN ADVANCE ESCALATING ROYALTY IN LIEU OF PRODUCTION FOR YEARS 11 THROUGH 20. THE DEPARTMENT HAS ENDORSED THIS CONCEPT BUT HAS SUGGESTED A HIGHER LEVEL FOR THE ADVANCE ROYALTY PAYMENTS.

   - DO YOU THINK THESE HIGHER ROYALTIES ARE NECESSARY IN ORDER TO PROVIDE A DISINCENTIVE FOR SPECULATIVE LEASE HOLDING?

The Department has not suggested a higher level for the advance royalty payments. Indeed, the proposal advanced by the Department contemplates a lower level for advance royalty payments than either S. 372 or S. 570, yet still provides a significant disincentive for speculative lease holding. The staff analysis in the September 1985 study demonstrates that the Department's minimum royalty proposed provides the appropriate disincentive for speculative lease holdings.

9 SEVERAL WESTERN GOVERNORS HAVE SUGGESTED THAT THESE ADVANCE ROYALTIES SHOULD BE AT LEAST ONE CENT PER TON PER YEAR FOR RECOVERABLE COAL HELD IN NONCOMPLYING LEASES. PLEASE COMMENT ON THIS RECOMMENDATION.

As indicated in the staff analysis of September 1985, a flat 1¢ per ton for recoverable coal held in noncomplying leases would have different regional impacts owing to the average reserves per lease in the different Federal regions as well as differences in regional coal market values. In the Powder River region, for example, which accounts for 78% of the Federal coal production nationally, a 1¢ per ton annual charge on recoverable reserves would be enormous when one realizes the low price in Powder River for produced coal as well as the relatively large reserve concentration in Powder River leases. Such a holding fee would not present the coal producer with any financial decision. That is, one would expect only those leases scheduled to enter production in the immediate term (e.g., within a year) would actually enter production. Otherwise one would expect relinquishment of the lease almost without regard to how close the lease was to production, including these leases that might otherwise have entered production within the next 4 to 5 years. This is shown on p. 82, Exhibit V-2, of the staff analysis, by the curve labeled "Udall".

By contrast, in the Green River-Hams Fork area, because of relatively less reserves per acre and substantially greater price for produced coal, the 1¢ per ton proposal would provide much more flexibility and allow a much greater holding period than in Powder River. Indeed, it would be approximately equivalent to the staff analysis of a .5 percent value-based minimum royalty.

The 1¢ per ton proposal, therefore, would have the undesireable effect of discouraging holding and production in that coal region containing the largest reserves of low sulfur, low cost, strippable coal, in favor of coal regions in which production costs are significantly higher.

10. LEGISLATION PROVIDING FOR THE PAYMENT OF ADVANCE ESCALATING ROYALTIES IN LIEU OF PRODUCTION COULD REQUIRE THAT LESSEES EXERCISING THIS OPTION MUST AGREE TO THE IMMEDIATE REVISION OF THEIR FEDERAL COAL LEASES TO REFLECT ALL STATUTORY AND REGULATORY REQUIREMENTS CURRENTLY IN EFFECT. WOULD THE DEPARTMENT SUPPORT THIS?

Subject, of course, to a reasonable grace period (one or two years) to allow lessees to decide on which leases to make a payment and which leases to relinquish, the Department would fully support such a legislative provision as resulting in the most rapid movement possible toward a market oriented (minimum royalty) diligence provision. The Department, however, still prefers a flat rate minimum royalty to an escalating schedule to accomplish this. In particular, the tax consequences of an escalating advance royalty, in addition to the increased administrative complexities of implementing such a schedule, indicate the same effect could more easily be achieved at a lower cost to both the companies and the government with a flat rate schedule.

11. THE DEPARTMENT'S DRAFT OF SUGGESTED CHANGES TO THE AMENDMENT TO H.R. 1934 IMPOSES NO LIMIT ON THE NUMBER OF YEARS WHICH A LESSEE COULD MAKE MINIMUM ROYALTY PAYMENTS IN LIEU OF PRODUCTION. HOW DOES THE DEPARTMENT JUSTIFY THIS RELINQUISHMENT IN FEDERAL CONTROL OVER THE PUBLIC LANDS INVOLVED?

The Department in no way sees such a proposal as relinquishing its control over the public lands. If Congress were to impose a flat holding fee or minimum royalty in lieu of production the Department sees no reason for limiting the lease term. The reason for this is that it would be highly unlikely that any lessee would find it profitable to make the minimum royalty payment continuously from years 11 through 20 of the lease in the absence of some production income from that lease. This is because the cost of money, associated with making those payments over such a period would sufficiently diminish profitability that the lessee would be unable to recover those costs even with full crediting pursuant to production beginning after year 20. In the possible, but unlikely, circumstance that a lessee has entered production late in the term of the lease but has not produced sufficient reserves to qualify under the current diligence provision of 1 percent, the Department sees no benefit from forcing relinquishment of that lease, particularly if that lessee continues to be willing to make the minimum payments.

Moreover, in response to questions from Senator Bingaman at the conclusion of its November 8 statement, the Department further recommended a rolling ten-year crediting provision which would permit only the latest 10 years of preproduction payments to be credited.

This notion in no way lessens the control the Department has over the public lands since (1) periodic readjustment dates may still be set in order to revise the terms of the lease as required; and (2) as noted above, it is highly unlikely that any lessee would make minimum royalty payments in lieu of production for as long a period as 10 years anyway.

12 SENATOR McCLURE'S AMENDMENT NO. 801 PROVIDES THAT RAILROADS OR AFFILIATED COMPANIES LEASING FEDERAL COAL MUST COMPLY WITH CERTAIN CONDITIONS (SUCH AS COOPERATIVE LEASING AND SHARING OF EXPLORATION DATA) ONLY IF THE SECRETARY OF THE INTERIOR FINDS THAT COMPETITION FOR THE FEDERAL LEASE WOULD BE "SUBSTANTIALLY ENHANCED THEREBY." WHILE I UNDERSTAND THE DEPARTMENT DOES NOT SUPPORT AMENDMENT NO. 801 AS WRITTEN, IF THE AMENDMENT WERE ENACTED, WHAT CRITERIA WOULD THE SECRETARY APPLY IN DETERMINING WHETHER COMPETITION WOULD BE "SUBSTANTIALLY ENHANCED?"

As indicated in the Department's November 8 statement, the Department sees no circumstances under which competition for the Federal lease would not be substantially enhanced by cooperative leasing. Therefore, we do not see that any criteria for determination of "substantially enhanced competition" are necessary and the Secretary would in the professional opinion of the Department's staff probably so find as a rebuttable presumption in each case.

13. AMENDMENT NO. 801 EMPLOYS THE TERM "POTENTIAL MINING UNIT." WHAT CRITERIA WOULD THE SECRETARY USE TO DESIGNATE "POTENTIAL MINING UNITS?"

At this time the Department has not established specific criteria to designate "potential mining units". Conceptually, the broad criteria would be that such a unit be a stand-alone mine, and the consideration for approval would be similar to that for mine plan approval, or tract delinated by RCT.

14 AMENDMENT NO. 801 PROVIDES FOR AN ADMINISTRATIVE COMPLAINT PROCEDURE AT THE DEPARTMENT OF THE INTERIOR WHEREBY AN AGGRIEVED COMPETITOR CAN ALLEGE THAT THE RAILROAD OR ITS AFFILIATE IS UNFAIRLY COMPETING. I UNDERSTAND THAT THE DEPARTMENT OPPOSES THIS PROVISION. HOWEVER, IF IT WERE ENACTED, HOW WOULD THESE ADMINISTRATIVE PROCEEDINGS BE HANDLED AT THE DEPARTMENT?

- WHAT IS THE ESTIMATED COST OF THESE ADMINISTRATIVE PROCEEDINGS?

The Department currently has no administrative process for adjudicating such a grievance. Substantial time and study are required to develop such a process, including preparation of regulations and guidelines describing how such an administrative proceeding would be handled. We have no estimate of the cost of developing such a procedure, nor of its continued implementation. Possibly a process similar to the IBLA may be necessary but we have not developed an concrete proposal.

15. I UNDERSTAND THAT THE INTERIOR BOARD OF LAND APPEALS ("IBLA"), ACTING ON BEHALF OF THE SECRETARY, HAS REFUSED TO REQUIRE READJUSTMENT OF PRE-1976 LEASES TO REFLECT THE ROYALTY RATE REQUIREMENTS OF FCLAA WHERE BLM IS LATE IN SENDING OUT NOTICES OF READJUSTMENT. ALSO, BLM HAS A REGULATION (43 CFR 3451.1(c)(2)) PROVIDING THAT THE AGENCY WAIVES READJUSTMENT OF LEASES UNDER CERTAIN CIRCUMSTANCES.

- WHAT IS THE BASIS FOR THE FAILURE BY THE DEPARTMENT TO READJUST LEASES TO INCORPORATE ROYALTY LEVELS MANDATED BY FCLAA?

By letter dated November 5, 1985, Senator Johnston requested the Department to give attention to allegations concerning Federal coal lease readjustment. BLM's November 25, 1985, response to Senator Johnston addresses the question and is attached for submittal for the record.

The Department has readjusted and is consistently readjusting Federal coal leases subject to the royalty provisions of FCLAA. In the past, some Federal coal lease readjustments had been waived as a result of Court decisions and IBLA and BLM interpretation of and conformance with the Court decisions. (As a result of readjustment waiver, the pre-FCLAA lease terms and conditions are continued until the lease is next readjusted.) For further discussion on Court precedent and subsequent interpretation, please refer to the response to question 7 and to page 2 of the BLM November 25, 1985, letter to Senator Johnston. We wish to further emphasize that administrative procedures were implemented in July 1984 to avoid future readjustment waivers. Please refer to the response to question 18 for a description of the administrative procedures.

3451 (660)

NOV 25 1985

Honorable J. Bennett Johnston
United States Senate
Washington, D.C. 20510

Dear Senator Johnston:

Thank you for your November 5, 1985, letter to Secretary Hodel requesting that we review the issues addressed in a November 4, 1985, letter to the Secretary from the Western Organization of Resource Councils, the Sierra Club, and Friends of the Earth (hereinafter referred to as "organizations"). The Secretary has requested that we respond to you directly.

We appreciate your interest in the issue of Federal coal lease readjustments and in the progress on legislation relating to the Federal Coal Management Program. As to the past history of Federal coal lease readjustments, it is commendable that the organizations have expended substantial time and effort to study the readjustment process based on the data furnished by the Bureau of Land Management (BLM). We are in full agreement with one of the organizations' primary conclusions, stated at two places in their letter, which clearly identifies this matter as being a complex web of deficiencies resulting from the practices of the previous Administration.

The BLM staff and officials began an in-depth review of the readjustment process and associated leases approximately 2 years ago. We completed our analysis in July 1984. As a result of our internal review, we restructured the Federal coal lease readjustment process. On July 6, 1984, the BLM State Directors were instructed (copy enclosed) to take specific actions in order to ensure that all Federal coal leases are timely readjusted. On December 7, 1984, the State Directors were further instructed (copy enclosed) to report quarterly on the status of readjustments. The quarterly reports are analyzed to ensure conformance with the established readjustment procedures and to identify and correct potential readjustment problems before they occur. Now that our automated Solid Leasable Minerals System (SLMS) is operational, we will also use automated data processing techniques to monitor Federal coal lease readjustments closely. The SLMS was designed to enhance our administration of all coal and solid leasable minerals on Federal and Indian lands. We have also established a chain of accountability for the quarterly reporting requirement in the Secretarial Management by Objective process.

With our identification and correction of readjustment procedural deficiencies, we are confident that our continuing attention to readjustments will ensure that the problems of the past are corrected. Our detailed responses to the concerns expressed in the November 4, 1985, letter follow.

At the outset, it should be noted that the organizations' assertions that BLM has readjusted Federal coal leases without subjecting them to the Federal Coal Leasing Amendments Act of 1976 (FCLAA) 12 1/2 percent royalty rate for surface-mined coal and the 10-year diligence requirement are not accurate. This statement reflects certain misunderstandings that will be clarified below.

As background, readjustments are made in accordance with the Mineral Leasing Act of 1920 (MLA) and FCLAA. The MLA, prior to amendment by FCLAA, provided that Federal coal leases shall be for indeterminate periods and that, at the end of each 20-year period succeeding the date of the lease, such readjustment of terms and conditions may be made as the Secretary of the Interior may determine. The FCLAA provides that the Federal coal lease will be subject to readjustment at the end of the primary term of 20 years and at the end of each 10-year period thereafter. (For leases issued prior to the enactment of FCLAA, the Department treats the first 20-year anniversary date that occurs after enactment of FCLAA as the "end of the primary term of 20 years"; the lease being subject to readjustment at the end of each 10-year period thereafter.)

Contrary to the assertions in the organizations' letter that readjustments occur by operation of law, we have been advised by the Solicitor's Office that the view most likely to prevail is that the statute requires action by the Department before a readjustment can occur. In several cases, the Interior Board of Land Appeals (IBLA) rulings have been premised on this assumption. Nonetheless, we have argued the contrary to IBLA through the Solicitor's Office, but no IBLA decision has expressly responded to this argument.

This interpretation that the Department must act to exercise its right to readjust has been incorporated in the regulations at 43 CFR Subpart 3451. It is consistent with the decision of the U.S. 10th Circuit Court of Appeals in the case of *Rosebud Coal Sales Co., Inc.* v. *Andrus*, 667 F.2d 949 (1982) and District Court decisions in *FMC Wyoming Corp.* v. *Watt*, Civ. No. C-83-347-K (D. Wyo. June 29, 1984), *Coastal States Energy Company* v. *Watt*, Civ. No. C-83-730J (D. Utah August 2, 1985), and *Gulf Oil Corporation and Pittsburg & Midway Coal Mining Company* v. *Clark*, Civ. No. CIV-84-0157-C (D. New Mex. April 1, 1985). Please note that all of these cases, except *Rosebud*, dealt with Federal coal leases which had post-FCLAA readjustment anniversary dates.

The November 4, 1985, letter interprets the *Rosebud* decision as stating that FCLAA does not apply retroactively to Federal coal leases with pre-FCLAA anniversary dates. This is not the interpretation of *Rosebud* by IBLA or the courts. *Rosebud* has been interpreted to mean that a lessee has the right to adequate notice (notice prior to the anniversary date) that the Department intends to exercise its right to readjust; the regulations are consistent with this interpretation and the *FMC*, *Coastal*, and *Gulf* cases proceeded based on that proposition. It is our position that this interpretation is reasonable since BLM had the same right to readjust prior to 1976 as it has now. This right was not altered procedurally by FCLAA; only the substance of the readjustments changed with FCLAA.

Since the regulations (43 CFR Subpart 3451) require notice before a readjustment is effective, they also provide that untimely readjustments are waived. By regulation, the Department must first send, prior to the readjustment anniversary date, a notice of intent to readjust; it then has 2 years to send the terms and conditions of the readjustment (by regulation, this second step may occur after the anniversary date). However, BLM policy, as specified in our July 6, 1984, instructions, is to issue the notice of intent to readjust 2 years prior to the readjustment anniversary date. The BLM policy also requires the issuance of the readjustment terms and conditions 6 months prior to the anniversary date. Under the existing regulations, if the notice of intent is sent after the anniversary date, or if the terms and conditions are not sent within 2 years of the notice of intent, the right to readjust the lease is waived. The BLM policy is designed to avoid waivers.

Readjustment waiver is misconstrued in the November 4, 1985, letter as a readjustment to pre-FCLAA terms. When a readjustment is waived, the lease is not readjusted subject to pre-FCLAA terms. Rather, no readjustment occurs and the pre-FCLAA terms continue until the lease is next readjusted. Our records show that no Federal coal leases have been readjusted to pre-FCLAA terms. Readjustment processing errors have occurred, primarily in the previous Administration, and some readjustments have been waived. These errors were examined during the internal review referred to above, and the cause of the errors has been corrected.

Contrary to the suggestion in the November 4, 1985, letter, the Secretary cannot simply inform the lessees holding waived-readjustment leases that their leases will now be readjusted by operation of law without difficult and possibly unsuccessful litigation. It would be questionable whether a court would uphold an action so directly in conflict with the Department's regulations that have uniformly, since long before 1976 and repromulgated in 1979, required action by BLM in order to readjust a coal lease.

In a fundamental misunderstanding, the November 4, 1985, letter asserts that readjustments which are *currently* pending before IBLA will be treated in the same manner as the few readjustments that were waived in the past. We believe that our actions on those readjustments currently before IBLA will ultimately be upheld, chiefly because we sent timely notice of readjustment to the lessee and all three court decisions (*FMC*, *Coastal*, and *Gulf*) on the issue affirm the adequacy of such notice.

As discussed above, the Department treats the end of the first 20-year period that occurs after the enactment of FCLAA as the "end of the primary term of 20 years" provided by FCLAA. Therefore, we are applying the 10-year period to Federal coal leases subject to and readjusted after the enactment of FCLAA. The BLM also takes this position regarding Federal coal leases, subject to readjustment after FCLAA, that had the first post-FCLAA readjustment waived. A case challenging our right to readjust a lease after 10 years when there was a waiver of the right to readjust at the end of the first 20 years is currently before IBLA.

The November 4, 1985, letter states that the Department has been granting 20-year readjustments. Although this has occurred on a few occasions, it is not BLM policy and has not happened for some time. Those 20-year readjustment lease terms were approved under unusual circumstances, based on one State Office's preliminary interpretation of advice from the Solicitor's Office. However, those leases were readjusted and are subject to FCLAA 10-year diligence and 12 1/2 percent royalty for surface-mined coal.

Rather than attempt to untangle the remaining misconceptions in the November 4, 1985, letter, we will provide the facts pertinent to the leases that the letter discusses.

It is asserted that BLM improperly readjusted 22 leases by applying pre-FCLAA terms. Of the 22 leases listed, two leases (c079641 and nm063466) are pending readjustment objection and appeal, respectively. We do not expect the readjustments to be waived. One lease (u020641) has been readjusted. Two of the leases (c012894 and u039706) were also listed as improperly readjusted by IBLA; these two leases are addressed in the paragraph below. One lease (u07746) was transferred by in lieu selection to the State of Utah, effective October 11, 1985; the readjustment of this lease had previously been waived. The remaining 16 lease readjustments were waived by State Office decision, based on previous IBLA and court decisions. The readjustment anniversary dates for 15 of these 16 leases occurred between 1977 and 1980.

The letter also stated that IBLA ordered the readjustment of 21 leases without the statutory requirements. There were only 20 leases listed and we could not identify one of those 20 (u01215). Apparently, the second part of a two-number (combined) lease was listed as a separate lease. The remaining 19 lease readjustments were declared by IBLA to have been waived. They were not readjusted with pre-FCLAA terms and conditions. Ten of the 19 leases were subject to readjustment after enactment of FCLAA. The readjustment anniversary dates for seven of these 10 leases occurred between 1976 and 1980. The other nine leases were identical to the Rosebud lease (i.e., subject to readjustment prior to enactment of FCLAA), contrary to the assertions in the November 4, 1985, letter.

Finally, the letter stated that the readjustment status of 63 leases was unclear. These leases were listed in a November 4, 1985, letter to the Acting Assistant Secretary for Land and Minerals Management. There were only 62 leases tabulated in that letter. Eleven of the 62 leases have been readjusted and 48 of the leases are pending administrative remedy (either objections filed with BLM, IBLA appeals, or Civil Suits). We have identified no readjustment procedural errors concerning the 48 leases and do not expect any of the readjustments to be waived. The remaining three leases have been or are in the process of being transferred to the State of Utah via in lieu selection. A listing of the readjustment status for the 62 leases is enclosed.

In summary, we have been acting in a manner consistent with law and regulations, and IBLA has been deciding the issues responsibly. In the majority of cases, IBLA has been upholding BLM's readjustments because they have been occurring in a timely manner. A copy of this letter is being sent to David Masselli, Brooks Yeager, and Geoff Webb.

If we can be of any further assistance, please do not hesitate to contact us.

Sincerely,

Robert F. Burford

Director

Enclosures

[illegible]

United States Senate

COMMITTEE ON
ENERGY AND NATURAL RESOURCES
WASHINGTON, DC 20510

November 5, 1985

0553

The Honorable Donald P. Hodel
Secretary of the Interior
U.S. Department of the Interior
Washington, D.C. 20240

Dear ~~Secretary Hodel~~: Don

I have received a copy of a letter dated November 4, 1985, sent to you by the Western Organization of Resource Councils, the Sierra Club, and Friends of the Earth, alleging "serious mismanagement" in the administration of the Federal Coal Leasing Program. Specifically, these groups maintain that the Bureau of Land Management has failed to apply the 12-1/2 percent royalty rate for surface-mined coal and the ten-year diligent development requirement, as mandated by the Federal Coal Leasing Amendments Act of 1976 ("FCLAA"), to all leases readjusted after enactment of the FCLAA.

Please give these allegations your immediate attention. I expect that the Department's witnesses at the Committee's November 8 hearing will be asked to comment on these charges. If well-founded, I believe these allegations could impede the Senate's progress on legislation relating to the Federal Coal Leasing Program.

Sincerely,

Bennett

J. Bennett Johnston
Ranking Minority Member

JBJ:pbr

November 4,1985

The Honorable Donald P. Hodel
Secretary of the Interior
Department of the Interior
Washington, DC 20240

Dear Secretary Hodel:

We are writing to call to your attention yet another instance of serious mismanagement in the administration of the Federal coal leasing program which threatens to deprive the public of hundreds millions of dollars of revenue and unjustly enrich a handful of favored coal lessees.

It has recently come to our attention that, notwithstanding clear statutory direction, field officials of the Bureau of Land Management and quasi-judicial employees of your office are failing to apply to readjusted Federal coal leases the 12 - 1/2% royalty (8 % for coal mined by underground methods) and ten year diligence period specifically required by the Federal Coal Leasing Amendments Act of 1976 (FCLAA) and the Department's regulations. Because of this, some leaseholders are reaping a windfall that may amount to millions of dollars per year on a single lease.

As you are well aware, Congress -- reacting to massive giveaways of public coal resources and the failure of the holders of such reserves to develop them -- established requirements in FCLAA that all new leases issued after 1976 contain mandatory provisions for a minimum 12 - 1/2% royalty and diligent development within ten years. After considering the matter, Congress decided not to immediately apply these two conditions to the more than 500 leases which had already been issued, but required that such terms would be applied to each and every "old" federal coal lease on its 20 year readjustment. Approximately 130 leases have been scehduled for readjustment since the passage of FCLAA.

The Department has used the alleged application of royalty and diligence terms on readjustment as one of its prime arguments for the repeal of Section 3 of FCLAA. It has argued that the application of diligence requirements on readjustment makes Section 3 redundant.

We had assumed that the process of readjustment was proceeding smoothly. However, as we began to analyze data made available to us earlier this year on the so-called "old" coal leases, we came across troubling discrepancies.

In response to a Freedom of Information Act request, the

Department made available approximately forty non-exempt elements of its Automated Coal Lease Data System. (Additional items, including royalty and coal quality data which had previously been made available to McGraw-Hill were denied us, making it difficult to estimate precisely the dollar cost of the improper readjustments.)*

Based on that rather incomplete data made available to us, it appears that BLM State offices have granted at least 22 lease readjustments at fifteen cents per ton -- approximately one-third to one-twentieth of the statutory royalty and significantly less than readjustment royalty the Department was using in the early 1970's ** Some of these leases were also renewed for a twenty year term rather than the ten year term required by FCLAA. An additional twenty-one leases had been improperly readjusted by the Interior Board of Land Appeals where, notwithstanding the announced position of the Department, IBLA was consistantly ordering that leases be renewed without the statutory minimum. *** Readjustment to the statutory terms had not been completed for as many as 70 additional leases which might be renewed on pre-FCLAA terms under some of the rulings handed down by IBLA.****

---

* Five of the improperly readjusted leases produced 2.88 million tons of c [illegible] 1983. They paid a total royalty of $432,000. Had the stat [illegible] yalty been imposed, based on published selling prices f [illegible] se leases, the total royalty would have been $5,183,7500. Thus, the loss to the Federal treasury was over $5 million dollars. The leases whose status we were not able to determine include 11 which produced 4.944 million tons in 1983.

** The following leases appear to have been improperly readjusted by BLM State Office according to information contained in ACLDS data made available to us: SL050862, E018804, S1062605, C012894,W075207, C037277, C079641, U07746, W055246, U020668, U38727, U46484, W038597, C011646, C0125457, C09005, W075206, W073289, W030052, U039706, U020641, NM065466. It is important to note that these State Office readjustments have occurred over the past 9 years, beginning at the end of 1976 and occurring as recently as January 1, 1985 for NM065466.

*** The Interior Board of Land Appeals has ordered post-FCLAA readjustments on pre-FCLAA terms in the following cases: Kaiser Steel, 63 IBLA 363; Franklin Real Estate 71 IBLA 13; Kaiser Steel, 76 IBLA 387; Pitkin Iron, 81 IBLA 81; Consolidation Coal Company, 87 IBLA 296. A number of additional cases are pending.

These cases involve twenty-one leases: SL069291, U02785, SL068754, U01215, SL048442-05115, SL071737, U025485, SL064903, SL058575, C07518, C07519, U017354, D056724, D047201, C012894, U039706, C020740, U073039, U073040, U073041.

**** We have identified 63 leases whose readjustment staus is unclear based on the ACLDS data. These leases are described in a letter to Acting Assistant Secretary Griles of this date.

There is litle apparent rhyme or reason to the pattern of errors. Sometimes leases issued in the same month twenty or forty years ago have been treated differently. Clearly, those leases which have been readjusted to comply with the law (as well as new leases) will face a siginficant competitive disadvantage vis-a-vis those leases which were not properly readjusted.

We would like to make it clear that we are not talking about "Rosebud" leases here. In the Rosebud case, Rosebud Coal Sales Company v Andrus, 667 F. 2d 949 (10 Cir.,1982) the Department attempted in 1977 to apply the FCLAA royalty to a lease which should have been readjusted in 1975, before FCLAA passed. The Court of Appeals ruled that the leaseholder had a right to have his leased renewed pursuant to the law which was in effect at the time the renewal should have taken place. All of the leases discussed above were slated for renewal after FCLAA and were governed by its terms.

Apparently, some of the renewals at the State Office levels were made by officials who misread Rosebud as applying to post-FCLAA renewals. Because the renewals were on terms favorable to the leaseholders, they, naturally, did not appeal. The only publicly available reports of the renewals, found in the annual Federal Coal Management Reports issued pursuant to Section 8 of FCLAA, made it appear that these renewals were pursuant to FCLAA.

The situation with IBLA is somewhat more complex. Beginning with its decision in Kaiser Steel 63 IBLA 363 (1982),IBLA has read Rosebud as establishing a principal that if the slightest procedural error were made in processing a lease readjustment, the applicant had an absolute right to a renewal on the previous terms, notwithstanding the passage of FCLAA. Because the previous administration had been grossly negligent in sending out notices of readjustrents, IBLA's position threatens to shelter dozens of "old" leases from the equitable royalty and diligence obligations which the law imposes on them. IBLA's application of the principals of landlord-tenant relations to the federal property power is, to say the least, unprecedented.

The underlying premise of the IBLA position on this issue: that mistakes, negligence or even a willful failure to implement FCLAA by low-level BLM employees can have the effect of nullifying the law is unprecedented and flies in the face of over 100 years of precedent dealing with public land law in this country. As the United States Court of Appeals for the District of Columbia Circuit stated in the leading case on the subject:

> The government is too vast, its operations too varied and intricate, to put it at risk of losing that which it holds for the nation as a whole because of the oversight of a subordinate official. Montana Power Co. v Federal Power Commission 185 F. 2d 491,497 (D.C. Cir, 1950), see also Albrechtsen v Andrus, 570 F. 2d 906 (10th Cir. 1978), Utah Power & Light v. U.S., 243 US 383 (1917).

IBLA, of course, in neither an independent agency nor a judicial body; it is an administrative unit established by regulation with delegated powers to render a final Departmental decision on certain issues. It acts for the Secretary and can take no action which the Secretary could not take.

It is our view that the lease readjustments discussed above are void because they do not comply with FCLAA. Therefore, as Secretary, you have the responsibility and duty to address this problem. We recognize that much of the blame for the events which gave rise to this situation occurred in a previous administration; however, the solution to the problem is your responsibility:

> The Secretary is the guardian of the people of the United States over the public lands. The obligations of the oath of office oblige him to see that the law is carried out, and that none of the public domain is wasted or is disposed of to a party not entitled to it. Knight v United States Land Association, 142 U.S. 181 (1891)

Furthermore, there is no doubt that as Secretary of the Interior you have the power to remedy mistakes made by subordinates:

> the Secretary of Interior has broad plenary powers over the disposition of public lands ... He has a continuing jurisdiction with respect to those lands until a patent issues and he is not estopped by the principles of res judicata or the finality of administrative action from correcting or reversing an erroneous decision by his subordinates or predecessors in interest. ... So long as the legal title remains in the Government, the Secretary has the power and duty upon proper notice and hearing to determine whether the claim is valid ... Therefore, even though the BLM had determined Ideal's claim to be valid and the Assistant Secretary approved as final the determination, the Department had authority to reconsider its final decision. Ideal Basic Industries, Inc. v. Morton 542 F. 2d 1364, 1367-1368 (9th Cir. 1976) quoted in Utah International v. Andrus, 488 F. Supp 962,967 (D. Utah 1979).

To remedy this situation, we believe that you should take the following steps:

1. Determine how many leases whose readjustment date came after August 4, 1976 have been issued readjustments which do not contain the statutory royalty or a ten year term.

2. Remove all further jurisdiction from IBLA over lease readjustments and announce a final position applying the FCLAA lease terms to all leases readjusted after August 4, 1976.

3. Issue orders to BLM State offices that all lease readjustments will contain the minimum 12 - 1/2% royalty and ten year term, regardless of when lease notification was sent.

4. Notify leaseholders with improperly readjusted leases that you are exercising your powers to modify their leases to reflect the appropriate statutory terms. No injustice will be done to such leaseholders who have been on notice of the relevant statutory requirements since 1976.

We believe that the facts in this matter are established and unequivocable, but we would be happy to meet with officials of the Department to discuss the most efficient approach to remedying previous administrative errors.

For more than twenty years, the Federal coal program has been characterized by repeated instances of incompetence, inconsistency, failure to comply with the law, and failure to protect the public's stake in the value of its holdings. It is a complex and highly technical program, large portions of which are hidden from public view and scrutiny. Apparently, whenever the spotlight of attention is not focused on the program, the BLM bureaucracy thinks it can give away the store.

"Business as usual" must come to an end if the coal program is to get back on its feet. We look forward to seeing you take prompt and decisive action to correct this situation.

David Masselli
Washington Counsel
Western Organization of Resource Councils

Brooks Yeager
Washington Representative
Sierra Club

Geoff Webb
Washington Director
Friends of the Earth

United States Department of the Interior
BUREAU OF LAND MANAGEMENT
WASHINGTON, D.C. 20240

IN REPLY REFER TO
3451 (662)

July 6, 1984

Instruction Memorandum No. 84-587
Expires 9/30/85

To: State Directors

From: Director

Subject: Federal Coal Lease Readjustments DD 8/15/84

Effective immediately, new practices will be initiated with regard to the readjustment of Federal coal leases. These changes are being initiated for our own administrative purposes and are not at variance with the requirements for the timing of readjustment notifications as set by the regulations. Readjustments done in a manner that provide the notifications required by the regulations are valid. However, you are instructed to follow these practices:

1. All lessees are to receive an "Initial Notice to Lessee that Lease Will be Readjusted" not later than 2 years prior to the lease readjustment anniversary date.
2. All lessees are to receive the "Notification of Readjusted Lease Terms" not later than 6 months prior to the lease readjustment anniversary date.
3. The development of special lease stipulations shall not delay the readjustment of leases because such stipulations can be made part of the exploration and mine plans if necessary.

To ensure that these practices are effected immediately and are fully implemented, you should take the following actions:

1. For leases not yet readjusted as of the anniversary date:

    - Immediately issue "Notification of Readjusted Lease Terms."

    NOTE: If the "Initial Notice to Lessee that Lease Will be Readjusted" for these leases is not sent prior to the anniversary date, the failure to notify may result in the lease readjustment being waived in accordance with 43 CFR 3451.1(c)(1). Report all such occurrences.

2. For leases currently within 3 months of the readjustment anniversary date, and for which the "Initial Notice to Lessee that Lease Will be Readjusted" has not been issued:

    - Immediately issue "Initial Notice to Lessee that Lease Will be Readjusted."

- Concurrently issue "Notification of Readjusted Lease Terms."

3. For leases currently within 3 months of the anniversary date, and for which the "Initial Notice to Lessee that Lease Will be Readjusted" has been issued but the "Notification of Readjusted Lease Terms" has not been issued:

   - Immediately issue "Notification of Readjusted Lease Terms."

4. For leases currently within 3 to 7 months of the anniversary date, and for which the "Initial Notice to Lessee that Lease Will be Readjusted" has not been issued:

   - Immediately issue "Initial Notice to Lessee that Lease Will be Readjusted."
   - Issue "Notification of Readjusted Lease Terms" prior to 2 months of the anniversary date.

5. For leases currently within 3 to 7 months of the anniversary date, and for which the "Initial Notice to Lessee that Lease Will be Readjusted" has been issued:

   - Issue "Notification of Readjusted Lease Terms" prior to 2 months of the anniversary date.

6. For leases currently within 7 to 24 months of the anniversary date, and for which the "Initial Notice to Lessee that Lease Will be Readjusted" has not been issued:

   - Immediately issue "Initial Notice to Lessee that Lease Will be Readjusted."
   - Issue "Notification of Readjusted Lease Terms" prior to 6 months of the anniversary date.

7. For leases currently within 7 to 24 months of the anniversary date, and for which the "Initial Notice to Lessee that Lease Will be Readjusted" has been issued but the "Notification of Readjusted Lease Terms" has not been issued:

   - Issue "Notification of Readjusted Lease Terms" prior to 6 months of the anniversary date.

8. For leases currently not within 24 months of the anniversary date:

   - Issue "Initial Notice to Lessee that Lease Will be Readjusted" 24 months prior to the anniversary date.
   - Issue "Notification of Readjusted Lease Terms" prior to 6 months of the anniversary date.

Note: For all cases where the "Initial Notice to Lessee that Lease Will be Readjusted" has been issued but the "Notification of Readjusted Lease Terms" has not been issued, review the "Initial Notice to Lessee that Lease Will be Readjusted" and determine the date, specified in the notice, by which the lease terms and conditions as provided by the "Notification of Readjusted Lease Terms" must be issued. If the "Notification of Readjusted Lease Terms," and consequently the lease terms and conditions, is not issued prior to the specified date, the lease readjustment may be waived, unless the delay is caused by events beyond the control of the Department, in accordance with 43 CFR 3451.1(c)(2). Report all such occurrences.

As those readjustment activities discussed above occur, you should develop a summary of actions taken and provide a report to me of those actions, including in that report details of any instance in which you are not able to comply with these instructions. The enclosed form provides a format for the reporting of readjustment actions. This report should be provided by August 15, 1984, (Attention: WO 640). During this same period, additional guidelines currently being prepared to support the continued implementation of readjustment procedures will be formalized.

James H Parker

James H. Parker
Associate Director

1 Enclosure
Encl. 1- Coal Lease Readjustments (1 p)

COAL LEASE READJUSTMENTS

I.M. ______ STATUS REPORT

LEASE NO.	ANNIVERSARY DATE	ACTIONS				
		INITIAL NOTICE DATE	DATE BY WHICH NOTIFICATION OF READJUSTED TERMS MUST BE SENT	DATE NOTIFICATION OF READJUSTED TERMS SENT	EFFECTIVE DATE OF READJUSTMENT	PROBLEMS

United States Department of the Interior
BUREAU OF LAND MANAGEMENT
WASHINGTON, D.C. 20240

FM
IN REPLY REFER TO:
3451 (662)
Relates to
IM 84-587 and
IB 84-307

December 7, 1984

Instruction Memorandum No. 85-142
Expires 9/30/85

To: All SD's

From: Director

Subject: Federal Coal Lease Readjustment, Quarterly Reporting DD 1/10/85 and thereafter

In order to assess progress in the use of the Federal coal lease readjustment procedures and activities specified in IM No. 84-587 and IB No. 84-307, the enclosed reporting requirements will be implemented. These requirements will also be included in the Secretarial MBO system. Solid Leasable Minerals System (SLMS) printouts will comprise a significant portion of the reports and shall be maintained up-to-date and accurate.

The required reports shall be submitted on a quarterly basis to Director (WO-660) within 7 workdays of the completion of each quarter. The first report is due January 10, 1985. (The SLMS printout portion of the reports is not required for the reports due January 10, 1985.) Solid Mineral Operations Division will analyze and compile reports and brief me on the findings.

The BLM Federal coal lease readjustment manual 3451 is under review and will be revised to enhance the readjustment process. The readjustment processing schedules as outlined in IM No. 84-587, July 6, 1984, are still in effect. Questions regarding this report should be directed to Paul Politzer, WO-660, at FTS 343-7722.

George F. Brown
George F. Brown
Deputy Director, Energy and Mineral Resources
Acting

1 Enclosure:
Encl. 1 - State Director Quarterly Report Federal Coal Lease Readjustments (3 pp)

STATE DIRECTOR
QUARTERLY REPORT
FEDERAL COAL LEASE READJUSTMENTS

Frequency: Quarterly
Due Date: 7 workdays following completion of each quarter
Recipient: Director (WO-660)

The Quarterly Report consists of 3 parts, as follow:

Part 1: Summary
Part 2: Solid Leasable Minerals System (SLMS) Readjustment Data Printout
Part 3: SLMS Readjustment Protest/Appeal/Civil Suit Printout

Part 1 (Summary)

Federal coal leases to be included:

- All leases with an anniversary date between January 1, 1984, and the end of the reporting quarter plus 2 years (e.g., for the report due January 10, 1985; include all leases with an anniversary date between January 1, 1984, and December 31, 1986).
- All leases for which the anniversary date has passed and the leases are still pending readjustment.

See Enclosure for Part 1 Format. Also included in the enclosure is a sample and explanation.

Part 1 shall be updated quarterly and resubmitted. Readjusted leases will be retained in the report.

Part 2 (SLMS Printout)

A SLMS program will be developed by WO-660 for the generation of this part of the report. The State Office will be instructed on the use of the query program when developed. All leases included in Part 1 shall be included in this part.

Part 3 (SLMS Protest/Appeal/Civil Suit Printout)

A SLMS program will be developed by WO-660 for the generation of this part of the report. The State Office will be instructed on the use of the query program when developed. All leases for which a protest, appeal or civil suit has been filed subsequent to January 1, 1984, shall be included in this part.

SAMPLE

STATE OFFICE: ____________________

STATE DIRECTOR
QUARTERLY REPORT--PART 1
FEDERAL COAL LEASE READJUSTMENTS

NOTE: RECORD LEASES CHRONOLOGICALLY BY ANNIVERSARY DATE

Report Date: ______

Page 1 of 1

Lease Number	Readjustment Anniversary Date	Date Initial Notice Sent To Lessee	Status (See Below) Check Appropriate Columns							Date Terms and Conditions Must Be Sent to Lessee	Date Terms and Cond. Sent to Lessee	Contest Status (See Below) Check Appropriate Columns								Was Adjmt. Waived	Effective Date of Readjustment
			(1)	(2)	(3)	(4)	(5)	(6)	(7)			(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)		
x7654	1/4/86	9/1/83	X	X	N/A	N/A	X	X	X	9/1/85	2/1/86	X	X	X						No	4/1/86
x7990	6/1/86	8/1/86	X	X			X	X	X	8/1/86	8/1/86	X	X							Yes	--
x9742	9/1/86	3/1/86	X	X	X			X	X	8/1/86 (3/1/86)	8/1/86									No	9/1/86
x10075	2/8/85	8/1/86	X	X	X	X	X	X		12/8/84 (8/1/86)											
x11122	9/1/85	8/1/86	X	X	N/A	N/A				3/1/85 (8/1/86)											
x22247	12/15/86	12/1/86	X	X	X					6/15/86(12/1/86)											

NOTES ON SAMPLE: --x7654 and x11122 N/A, not applicable entered for Status, Column 3, as the surface is BLM administered.
--x7990 adequate time did not exist to request SMA Comments.
--x9742 to x22247 in the "Date Terms and Conditions Must Be Sent" column the first date is the submittal date as required by IM 84-587; the second date is the date specified in the initial notice

Status:
(1) Initial Notice Sent to Lessee
(2) District Office Recommendations Requested
(3) SMA Recommendations Requested
(4) SMA Comments Received
(5) District Office Recommendations Received
(6) Terms and Conditions Sent to Lessee
(7) Attorney General Notified

Contest Status:
(1) Protest Pending
(2) Protest Decided
(3) Appeal Pending
(4) Appeal Decided
(5) 1st Civil Suit Pending
(6) 1st Civil Suit Decided
(7) 2nd Civil Suit Pending
(8) 2nd Civil Suit Decided

Enclosure 1-2

Readjustment Status as of September 30, 1985, for 62 Federal Coal Leases Identified in November 4, 1985, Letter to Assistant Secretary Griles

NOTE: No Currently Pending Lease Readjustments are Expected to be Waived

R =Readjusted
RC=Readjustment under Civil Suit
RA=Readjustment under Appeal to IBLA
RO=Readjustment Pending Objection filed with State Office
RD=Readjustment Objection Decided, Time to file Appeal has not Expired

Serial Number	Date Issued	Status
SL031286	09/04/23	RO
C033800	10/08/24	RO
D034365	10/25/24	RA
D051698	09/11/41	RO
SL062583	09/11/41	RC
SL063058	08/03/42	RC
S032582	09/09/43	R
SL062966	11/12/43	R
SF077115	07/27/44	R
SL064507	11/01/44	R
D052558	12/14/44	RO
SL064900	02/03/45	RA
D052547	03/01/45	RO
W054727	11/01/61	RA
W054728	11/01/61	RA
W054737	11/01/61	RA
U067498	01/01/62	RA
U020305	03/01/62	R
U040151	03/01/62	RA
U053995	03/01/62	RA
U083066	03/01/62	RA
U089096	07/01/62	*
U090231	11/01/62	RA
U092147	12/01/62	*
C023703	03/01/63	RA
W061421	03/01/63	RC
W061422	03/01/63	RC
C024998	10/01/63	RO
C081330	11/01/63	RA
U0126947	12/01/43	R
U0126948	12/01/63	R

*Being transferred to State of Utah; readjustment Civil Suit withdrawn.

· NOTE: No Currently Pending Lease Readjustments are Expected to be Waived

R =Readjusted
RC=Readjustment under Civil Suit
RA=Readjustment under Appeal to IBLA
RO=Readjustment Pending Objection filed with State Office
RD=Readjustment Objection Decided, Time to file Appeal has not Expired

Serial Number	Date Issued	Status
U073120	02/01/64	RD
C0114093	05/01/64	RO
U083005	08/01/64	R
U084923	08/01/64	RA
U084924	08/01/64	RA
U0142235	10/01/64	RA
C029889	11/01/64	RD
M065329	12/01/64	R
U083000	12/01/64	R
C0115606	01/01/65	R
C0125485	01/01/65	RO
C12638	01/01/65	RO
C7835	01/01/65	RO
U0140770	01/01/65	RA
W0220516	03/01/65	RO
W0256663	03/01/65	RO
C081251	05/01/65	RO
C081258	05/01/65	RO
C0117192	06/01/65§	RO
U0101213	06/01/65	RO
U0101214	06/01/65	*
U0101215	06/01/65	RO
U0101217	06/01/65	RO
U0101218	06/01/65	RO
U0105404	06/01/65	RA
U098774	06/01/65	RA
U098775	06/01/65	RA
W0312918	06/01/65	RO
W0313559¶	06/01/65	RA
M069782	07/01/65	RA
W0312311	07/01/65	RA

§November 4, 1985, letter listed issue date as 06/01/85.

*Transferred to State of Utah effective February 8, 1985.

¶November 4, 1985, letter listed serial number as W0313550.

NOTE: No Currently Pending Lease Readjustments are Expected to be Waived

SUMMARY OF STATUS FOR 62 FEDERAL COAL LEASE READJUSTMENTS

11: R =Readjusted
4: RC=Readjustment under Civil Suit
22: RA=Readjustment under Appeal to IBLA
20: RO=Readjustment Pending Objection filed with State Office
2: RD=Readjustment Objection Decided, Time to file Appeal has not Expired
59: Total

In addition, two Federal coal leases are currently being transferred to the State of Utah via in lieu selection; their readjustment Civil Suit has been withdrawn. One Federal coal lease was transferred to State of Utah via in lieu selection effective February 8, 1985. Total of 62 Federal coal leases.

16. IN READJUSTING PRE-1976 LEASES, HAS THE DEPARTMENT, SINCE 1976, INCLUDED THE FCLAA REQUIREMENT OF DILIGENT DEVELOPMENT OF THE LEASE WITHIN A 10-YEAR PERIOD?

- IF NOT, WHY NOT?

The BLM November 25, 1985, readjustment response to Senator Johnston (see also the response to question 15) addresses the readjustment of leases subject to FCLAA 10-year diligence. To summarize the BLM response, the Department has readjusted and is consistently readjusting leases subject to FCLAA 10-year diligence and royalty rates, and otherwise conforming the leases by readjustment to "new", post-FCLAA lease standards and requirements. As stated in our response to question 15, some lease readjustments had been waived and the pre-FCLAA lease terms and conditions continued as a result of the waivers.

17. COULD YOU PROVIDE FOR THE RECORD A DISCUSSION OF THE LEGAL OPINIONS UPON WHICH THE DEPARTMENT IS BASING ITS POSITION REGARDING POST-1976 LEASE READJUSTMENT? PLEASE SPECIFICALLY INCLUDE A DISCUSSION OF ROSEBUD COAL SALES COMPANY, INC. V. ANDRUS, 667 F.2d 949 (10th CIR. 1982), AND CALIFORNIA PORTLAND CEMENT CO. V. ANDRUS, 667 F.2d 953 (10th CIR. 1982), AND WHETHER THE DEPARTMENT VIEWS THOSE CASES AS DISTINGUISHABLE FROM CASES INVOLVING LEASES WITH POST-1976 ANNIVERSARY DATES.

Some opinions have been publicly available, such as Solicitor's Opinion M-36939, 88 I.D. 1003 (1981); Solicitor's Opinion, M-36920, 87 I.D. 69 (1979); and Letter dated September 12, 1978, to Senator Henry Jackson from Frederick N. Ferguson, Deputy Solicitor. These state that a pre-1976 lease, when readjusted, must be readjusted to conform to FCLAA, but they do not discuss the difference between leases with pre- and post-1976 anniversary dates.

On that issue, any legal advice that has been rendered informally has taken into account the decision in Kaiser Steel Corp., 63 IBLA 363 (1982), which was rendered by the Interior Board of Land appeals (IBLA) acting for the Secretary. It applied Rosebud Coal Sales Company, Inc. v. Andrus, 667 F.2d 949 (10th Cir. 1982), and California Portland Cement Co. v. Andrus, 667 F.2d 953 (10th Cir. 1982), to leases with both pre- and post-1976 anniversary dates. The IBLA found Rosebud controlling on the issue of notice.

The IBLA's decision in Kaiser was consistent with prior administrative practice. The Department had always construed the statutory language stating that leases were "subject to readjustment" as meaning that action by the Secretary was necessary before readjustment occurred. it is the requirement for agency action which gives rise to the corresponding requirement that the action be timely. That requirement was also embodied in the regulations promulgated by the previous Administration. As was stated in the November 25, 1985, BLM letter to Senator Johnston, it is those regulations which foreclose any realistic legal possibility of now seeking to readjust any leases for which readjustments were previously deemed waived.

18. WHY HAS BLM BEEN LATE SENDING OUT READJUSTMENT NOTICES?

- WHAT STEPS ARE BEING TAKEN TO PREVENT TARDINESS IN ISSUING READJUSTMENT NOTICES IN THE FUTURE?

The past late transmission of readjustment notices to lessees primarily occurred during the implementation of the 1976 regulatory provisions (43 CFR 3522.2-1(b)) for the readjustment of leases to subject them to FCLAA and subsequent regulatory revision in 1979 (43 CFR Subpart 3451). The 1976 regulations provided for the issuance of a notice of intent to readjust prior to the readjustment anniversary "if feasible"; the 1979 regulations continued this provision for leases subject to readjustment prior to June 1, 1980. Further, the 1979 regulations provided that a notice of intent to readjust must be issued prior to the readjustment anniversary date, if that date occurs after June 1, 1980, and the failure to issue the notice prior to the anniversary date constitutes a waiver of BLM's right to readjust.

Court decisions (Rosebud (1982)) and subsequent interpretations (Kaiser 1982)) held that notice of intent to readjust must be issued prior to the readjustment anniversary date. The decisions and interpretations held that the 1976 and 1979 regulatory provisions allowing for issuance of a notice after the anniversary were improper. As a result of the decisions and interpretations, the readjustment was waived for 26 leases with anniversary dates preceding June 1, 1980. Readjustment waiver also occurred for four leases with 1982 anniversary dates. One of the four 1982 waivers occurred because of direct nonconformance with the regulatory notification timing requirements. The remaining three of the four waivers resulted because readjustment notification was provided to only one of the two lessees jointly holding the three leases. Consolidation Coal Co. and Gulf Oil Corp., 87 IBLA 296 (1985).

In July 1984, BLM implemented internal readjustment procedural requirements designed to ensure that past readjustment failures would not continue. The procedures require BLM State Offices to: 1) issue "notice of intent to readjust" 2 years prior to the readjustment anniversary date (the regulations require issuance of the notice of intent prior to the anniversary); 2) issue "notice of readjusted terms and conditions" 6 months prior to the readjustment anniversary date (the regulations require issuance of the notice of readjusted terms and conditions within 2 years of issuance of notice of intent); and 3) issue readjustment notices to each party recorded as lessee-of-record. The scheduling and notification requirements assure that the readjustments will become effective on the readjustment anniversary date. Close monitoring of readjustment activity shows that BLM State Offices are complying with the procedures and past failures are not being repeated.

19. S.570 WOULD TOTALLY REPEAL THE REQUIREMENT THAT LOGICAL MINING UNITS (LMU's) BE CONTIGUOUS. A PROPOSAL BEFORE THE HOUSE OF REPRESENTATIVES (H.R. 1934) WOULD ALLOW NONCONTIGUOUS AREAS TO BE INCORPORATED INTO AN LMU ONLY IF THEY ARE WITHIN REASONABLE PROXIMITY OF EACH OTHER AND UNDER THE EFFECTIVE CONTROL OF A SINGLE OPERATOR AND INCORPORATED INTO A SINGLE OPERATION.

- DOES THE DEPARTMENT ENDORSE EITHER COMPLETE REPEAL OR THE HOUSE APPROACH?

- WHAT STEPS WOULD THE DEPARTMENT TAKE TO ENSURE THAT LMU's ARE NOT USED AS A VEHICLE TO CIRCUMVENT THE DILIGENT DEVELOPMENT AND CONTINUED OPERATION REQUIREMENTS OF THE MLA?

The Department endorses complete repeal of the continguity requirement because it does not take into account geologic or geographic complexities that occur in many potential LMU areas. The current statutory language incorporates the requirements that all lands within an approved LMU be under the effective control of a single operator and be capable of being mined as a single operation.

The requirements of the MLA and the implementing regulations prevent LMU circumvention of the MLA diligent development and continued operation requirements. The requirements that the LMU be mined as a single operation, not encompass more than 25,000 acres, and be mined-out in 40 years years, limit the area and reserve extent of LMU's and prevent the inclusion of a lease in an LMU when mining of the lease would not occur through the logical extension of mining operations. Further, the LMU is subject to FCLAA diligent development and continued operation. If an approved LMU were to fail, the Federal leases within that LMU would be evaluated individually for compliance with their lease-specific diligence requirements as if the LMU had never been approved. The findings of the evaluation could result in immediate action to terminate or cancel all or some of the leases that were contained in the LMU. Because of the LMU approval and operating requirements, and the impact LMU failure could have on the leases contained in the LMU, we believe Federal coal lessees will not lightly undertake the formation of an LMU.

20. THE DEPARTMENT's INTERIM FINAL RULEMAKING ON LMU's, PUBLISHED ON OCTOBER 2, 1985 (50 FR 40197), PROVIDES THAT AN AUTHORIZED DEPARTMENTAL OFFICER WOULD BE ABLE TO ESTABLISH THE EFFECTIVE DATE OF AN LMU AT ANY TIME BETWEEN THE DATE OF RECEIPT OF THE APPLICATION AND THE APPROVAL DATE.

- COULD YOU PLEASE PROVIDE FOR THE RECORD INFORMATION REGARDING THE NUMBER OF LMU APPLICATIONS PENDING AT THE DEPARTMENT, THE DATE OF EACH APPLICATION, AND THE AREA COVERED BY EACH APPLICATION?

- HOW MANY, IF ANY, CURRENTLY NONCOMPLYING FEDERAL COAL LEASES WOULD BE BROUGHT INTO COMPLIANCE THROUGH APPROVAL OF THESE PENDING LMU APPLICATIONS?

There are currently nine LMU applications pending before BLM. The requested basic information on the LMU's follows. Also, we have estimated, based on current and projected production scenarios, the number of Federal leases in each LMU that may not conform with the Section 2(a)(2)(A) lessee-qualification requirements on August 4, 1986, if the LMU were not approved. The lessee-qualification requirement comes into effect on August 4, 1986, and our identification of "nonconforming" leases is based on projected lease-specific production scenarios on that date if they are not contained in an LMU. Please note that a lease projected to conform on August 4, 1986, may later become nonconforming as mining operations progress off the lease. Also please note that production (Federal and/or non-federal) is currently occurring within the proposed boundaries of all the pending LMU's.

1. Application date: July 22, 1983
   Applicant: Mobil Coal Producing, Inc.
   Proposed acreage and location: 6,824 acres, Campbell County, Wyoming
   Proposed LMU encompasses:
      o NonFederal coal holdings
      o One pre-FCLAA issued Federal coal lease

Nonconforming Federal coal leases (absent LMU formation) on August 4, 1986: None

2. Application date: August 15, 1983
   Applicant: Colorado Yampa Coal Company
   Proposed acreage and location: 1,595 acres, Routt County, Colorado
   Proposed LMU encompasses:
      o Non-federal Coal holdings
      o One pre-FCLAA issued Federal coal lease

Nonconforming Federal coal leases (absent LMU formulation) on August 4, 1986: One

3. Application date: October 11, 1984
   Applicant: Gulf Oil Corporation and Pittsburg and Midway Coal Mining Company

Proposed acreage and location: 24,110 acres, McKinley County, New Mexico
Proposed LMU encompasses:
- Non-federal Coal holdings
- Four pre-FCLAA issued Federal coal leases

Nonconforming Federal coal leases (absent LMU formation) on August 4, 1986: Three.

4. Application date: December 26, 1984
Applicant: Exxon Coal
Proposed acreage and location: 5,537 acres, Campbell County, Wyoming
Proposed LMU encompasses:
   - NonFederal coal holdings
   - One pre-FCLAA issued Federal coal lease
   - One post-FCLAA issued Federal coal exchange lease

Nonconforming Federal coal leases (absent LMU formation) on August 4, 1986: None. The post-FCLAA lease is projected to become nonconforming in 1993, 10 years from the effective date of the exchange lease.

5. Applicant date: April 16, 1985
Applicant: North Antelope Coal Company
Proposed acreage and location: 2,000 acres, Campbell County, Wyoming
Proposed LMU encompasses:
   - NonFederal coal holdings
   - Two pre-FCLAA issued Federal coal leases

Nonconforming Federal coal leases (absent LMU formation) on August 4, 1986: Two

6. Application date: August 8, 1985
Applicant: Kerr McGee Coal Corporation
Proposed acreage and location: 4,103 acres, Campbell County, Wyoming
Proposed LMU encompasses:
   - nonFederal coal holdings
   - Two pre-FCLAA issued Federal coal leases

Nonconforming Federal coal leases (absent LMU formation) on August 4, 1986: Two

7. Application date: August 13, 1985
Applicant: Gulf Oil Corporation and Pittsburg and Midway Coal Mining Company
Proposed acreage and location: 6,060 acres, Routt County, Colorado
Proposed LMU encompasses:
   - NonFederal coal holdings
   - Four pre-FCLAA issued Federal coal leases

Nonconforming Federal coal leases (absent LMU formation) on August 4, 1986: Three

8. Application date: September 16, 1985
   Applicant: Western Fuels-Utah, Inc.
   Proposed acreage and location: 6442 acres, Rio Blanco County, Colorado
   Proposed LMU encompasses:
   - Two pre-FCLAA issued Federal coal leases
   - Three post-FCLAA issued Federal coal leases

Nonconforming Federal coal leases (absent LMU formation) on August 4, 1986: None. The post-FCLAA leases are also projected to conform in 1992, the end of the 10-year holding period.

9. Application date: September 23, 1985
   Applicant: Gulf Oil Corporation and Pittsburgh and Midway Coal Mining Company
   Proposed acreage and location: 15,449 acres, Lincoln County, Wyoming
   Proposed LMU encompasses:
   - NonFederal coal holdings
   - Six pre-FCLAA issued Federal coal leases
   - One post-FCLAA issued Federal coal leases

Nonconforming Federal coal leases (absent LMU formation) on August 4, 1986: Not yet determined. In 1981 Gulf and Pittsburgh and Midway acquired control of Kemmerer Coal Company which then held the leases now included in the pending LMU. If the acquisition did not start a new assignee's 10-year clock, the six pre-FCLAA leases would be nonconforming on August 4, 1986.

21. THE DEPARTMENT OF THE INTERIOR'S DRAFT OF SUGGESTED CHANGES TO THE AMENDMENT TO H.R. 1934 WOULD ELIMINATE NON-FEDERAL ACREAGE FROM THE 25,000-ACRE ACREAGE LIMITATION ON LMU'S, THUS ALLOWING LMU'S TO BE LARGER. WHY?

Eliminating non-Federal acreage from the acreage limitation would enable a logical sequence of recovery for Federal and non-Federal holdings. As an example, Pittsburg-Midway in New Mexico had to segregate certain of its non-Federal holdings to comply the acreage limitations, potentially interrupting an otherwise logical recovery sequence.

22 SENATOR JOHNSTON'S BILL, S. 372, CONTAINS A PROVISION DEFINING "COMPETITIVE BIDDING" AS THE RECEIPT OF BIDS BY AT LEAST TWO BIDDERS.

- PLEASE COMMENT ON THIS METHOD OF ENSURING THAT FAIR MARKET VALUE IS OBTAINED FOR FEDERAL COAL.

Certainly one would expect that if there were strong competition for a lease that the high bid from a willing but not obligated buyer submitted to the Department, a willing but not obligated seller, would result in fair market value being obtained for Federal coal. Whether or not this is true with receipt of only two bids is somewhat speculative. Certainly, two bidders constitute the minimum requirement for significant competition. If both of the bids were "serious" bids it is highly likely they would result in obtaining fair market value for the Federal coal. To develop bid acceptance criteria the Department currently employs qualification criteria bid screen as an attempt to differentiate serious bids from bids that are more likely to be spurious or "noise" bids. This procedure, in concert with an averaging procedure that includes our pre-sale appraised value, is used to take advantage of the market information received at the time of sale to allow us to make a determination of whether or not the apparent high bid represents fair market value.

The Department does not favor defining "competitive bidding" as the receipt of bids by at least two bidders, for the purpose of ensuring that fair market value is obtained for Federal coal leases. Depending on other factors, two bids or two bidders may or may not be sufficient to ensure that fair market value is obtained. For example:

- Under sealed bidding, the mere threat of other bidders secretly entering the auction may cause the sole bidder to offer fair market value. Thus, fair market value may be obtained competitively even though there is only one actual bidder.

- Under oral bidding, if the bidding is allowed to start off at a low price level, then much apparent but meaningless bidding competition could occur. Thus, even the participation of several bidders may not be sufficient, in and of itself, to ensure that fair market value is obtained.

"Competitive bidding" is a process--the public offering of the opportunity to compete economically for the lease award. The process forces a bidder, even if it eventually is the only bidder, to deal with the uncertainty that others may bid, or Interior may reject the bid, by declaring what it is willing to pay. Unless S. 372 also provided that the Secretary may issue a lease absent competitive bidding (that is, when only one bid is received), the definition only serves to prohibit leasing even when fair market value is received from the one bidder. Any attempt to prohibit one-bid leasing ignores the realities of surface ownership and State and private coal ownership over and amidst Federal tracts. In our opinion attempting to legislate competition in this way that such coal cannot be leased is to disrupt economically sound development of competing coal reserves.

23. WHAT STEPS IS THE DEPARTMENT TAKING TO ENSURE THAT THE FEDERAL COAL DEPOSITS ARE PROPERLY APPRAISED PRIOR TO LEASING TO ENSURE THAT FAIR MARKET VALUE IS RECEIVED?

In July of this year, the Department prepared its final draft of its guidelines to Federal Coal Property Appraisal which it believes will go a long way toward ensuring that Federal coal deposits are properly and consistently appraised from region to region. The regional evaluation teams also receive training from professional appraisers.

24. WHAT STEPS IS THE DEPARTMENT TAKING TO ENSURE THAT ITS APPRAISALS ARE BASED ON ADEQUATE DATA?

The Department has proposed several modifications in, or clarifications of, regional activity planning procedures to ensure that the data available to resource evaluators are adequate for generating reliable estimates of the values of coal lease tracts being considered for lease sale. These proposals include a provision for appointing a review council and specifying in national guidance the types of financial data to be required for approval of Federal coal lease transfer (assignment, sublease, etc.).

In the regional activity planning phase, the review council, composed of individuals knowledgeable about coal resource evaluation, would provide informed opinions on whether or not sufficient data about prospective lease tracts exist to make reliable determinations of fair market value. Finally, in an attempt to give the resource evaluators as much information about market conditions as possible, the Department would specify in national guidance the types of financial data to be required for approval of Federal coal lease assignments. This guidance would clarify a provision in the coal management regulations which requires each applicant for a coal transfer to be accompanied by a statement of all consideration paid or promised for the transfer. The financial data would be considered by the Department in appraising tracts comparable to the tract covered by the assigned lease. Additionally, the Department has published A Guide To Federal Coal Property Appraisal, which specifies the types of information necessary for appraisal and requires documentation of data and source.

25. SEVERAL WESTERN GOVERNORS HAVE RECOMMENDED THAT THE ROLE OF THE STATES IN THE FEDERAL COAL LEASING PROGRAM BE CODIFIED. SPECIFICALLY, THEY SUGGEST THAT: FIRST, THE STATUTORY LANGUAGE MANDATE, AT THE REQUEST OF THE STATES, THE ESTABLISHMENT OF JOINT FEDERAL-STATE TEAMS TO GUIDE ALL PHASES OF FEDERAL COAL, OIL SHALE, AND TAR SANDS LEASING: AND SECONDLY, THAT THE STATUTE REQUIRE CERTAIN CONSULTATION WITH THE STATES PRIOR TO ACTION WITH RESPECT TO A LEASE.

- WHAT IS THE DEPARTMENT's POSITION ON THESE RECOMMENDATIONS?

The Department supports Federal-State cooperation in the disposition of public lands and resources and consultation with State governors prior to leasing decisions. In fact, for the Federal coal and oil shale leasing programs the Department has chartered Federal-State advisory bodies to provide recommendations at major decision points in the administrative processes leading to leasing decisions and receive information regularly about coal and oil shale lease management activities. The requirement to consult with State governors at critical points is also included in the coal and oil shale program regulations.

We believe that providing for Federal-State teams, describing their duties in charters and regulations and requiring gubernatorial consultation in regulations sufficiently ensure that State concerns and issues will be considered. We do not believe that any group's right to be consulted, no matter how legitimate, should be elevated by statute above any other group's right to be consulted. Groups other than the States have views on how mineral leasing programs should be conducted and would press justifiably for statutory recognition of their viewpoints. The result would be a greatly lengthened law which merely codifies existing requirements that the Department implements and expects to continue to implement.

(26) THE DEPARTMENT OF THE INTERIOR ISSUED ITS SUPPLEMENTAL FINAL ENVIRONMENTAL IMPACT STATEMENT FOR THE FEDERAL COAL LEASING PROGRAM LAST MONTH. WHAT LEVEL OF NEW LEASING IS THE DEPARTMENT ANTICIPATING?

- WILL CURRENT MARKET CONDITIONS AND DEMAND FOR COAL BE TAKEN INTO ACCOUNT PRIOR TO ANY ADDITIONAL LEASING?

The Department of the Interior is not anticipating any particular level of new leasing. The Supplemental Final Environmental Impact Statement for the Federal Coal Leasing Program did not analyze the impacts of leasing different levels of coal but alternative programs by which federal coal could be leased, regardless of amount. Specific leasing levels in federal coal production regions will be determined jointly by the appropriate RCT and the Secretary during activity planning.

Under the proposed action alternative studied in the EIS supplement, market conditions would be gauged at three points during regional activity planning by using a three-tiered market analysis. The first tier would be the long-range market analysis, consisting mainly of coal production forecasts and coal production capacity estimates for the coal production regions. The purpose of the long range market analysis would be to assess the need to begin regional activity planning.

The second tier would be the regional market analysis, performed to determine the various levels of leasing needed to meet certain leasing objectives. These objectives include fostering a stable market for in situ coal, promoting competition for utility contracts, and providing the opportunity to acquire Federal coal leases to meet domestic energy needs. This analysis would provide the regional coal teams with information for its leasing level recommendation to the Secretary.

The final tier is the current market and tract marketability analysis, which would provide information about the then current coal market and the potential demand for the coal lease tracts being studied for potential sale. This analysis would provide information to the regional coal team in formulating its lease sale schedule recommendation to the Secretary.

26. THE DEPARTMENT OF THE INTERIOR ISSUED ITS SUPPLEMENTAL FINAL ENVIRONMENTAL IMPACT STATEMENT FOR THE FEDERAL COAL LEASING PROGRAM LAST MONTH. WHAT LEVEL OF NEW LEASING IS THE DEPARTMENT ANTICIPATING?

- WILL CURRENT MARKET CONDITIONS AND DEMAND FOR COAL BE TAKEN INTO ACCOUNT PRIOR TO ANY ADDITIONAL LEASING?

The Supplemental Final Environmental Impact Statement for the Federal coal Management Program forecasted low, medium, and high production levels for the major Federal coal production regions for the years 1990, 1995, and 2000. At the national level of aggregation the alternative production levels do not differ. The estimated total United States production for the year 1990 in the major coal production regions is 899 M/T per year for the low production level, 984 M/T per year for the medium production level, and 1041 M/T per year for the high production level. For the year 2000 the forecasts call for 1165 M/T per year for the low production level, 1222 M/T per year for the medium production level, and 1416 M/T per year for the high production level. However, these numbers mask significant shifts in production among the major Western Federal coal regions.

The Department has reasonable confidence in these near term projections and fully expects low levels of leasing generally, with scattered emergency, bypass, and maintenance leasing, and with selected support for some phased sales in certain Federal coal production regions.

Under the proposed action alternative studied in the EIS supplement, market conditions would be gauged at three points during regional activity planning by using a three-tiered market analysis. The first tier would be the long-range market analysis, consisting mainly of coal production forecasts and coal production capacity estimates for the coal production regions. The purpose of the long range market analysis would be to assess the need to begin regional activity planning.

The second tier would be the regional market analysis, performed to determine the various levels of leasing needed to meet certain leasing objectives. These objectives include fostering a stable market for in situ coal, promoting competition for utility contracts, and providing the opportunity to acquire Federal coal leases to meet domestic energy needs. This analysis would provide the regional coal team with information for its leasing level recommendation to the Secretary.

The final tier is the current market and tract marketability analysis, which would provide information about the then current coal market and the potential demand for the coal lease tracts being studied for potential sale. This analysis would provide information to the regional coal team in formulating its lease sale schedule recommendation to the Secretary.

At this time the date by which the processing of coal PRLAs will be completed is not known. If agreement with the conservation groups is reached and the court accepts the proposed replacement order, complying with the terms of the agreement is expected to add 24 months to the processing of those coal PRLAs requiring EISs. In addition, for the past 2-1/2 fiscal years, Congress has imposed, through the appropriations process, a prohibition on processing in any way coal PRLAs lying within BLM wilderness study areas. A total of 16 coal PRLAs - 7 in Utah, 6 in New Mexico, and 3 in Montana - are caught in the "section 308" prohibition in Interior's appropriations act. (See, for instance, the Interior appropriations acts for 1984 and 1985). In New Mexico, the completion of PRLA processing is further complicated by litigation over the ownership of mineral rights, including coal.

27 HOW DO THE FOLLOWING FACTORS RANK AS POLICY OBJECTIVES FOR THE FEDERAL COAL LEASING PROGRAM:

(1) MAXIMIZATION OF REVENUES;

(2) PRESERVATION OF THE ENVIRONMENT; AND

(3) ENERGY PRODUCTION?

- WHAT OTHER FACTORS DO YOU BELIEVE SHOULD BE CONSIDERED IN FORMULATING COAL LEASING POLICY?

In addition to the policy objectives indicated above, the Department also considers as policy objectives:

- the orderly and timely development of coal resources;
- receipt of fair market value for the public;
- promotion of free market processes;
- efficient and logical resource development; and
- the provision of public services at least cost to the taxpayer.

These policy objectives, as well as those itemized in the question, are all considered to be important and are not ranked. Rather, alternative policy options are scored against all objectives to determine that option or options which best satisfy all relevant objectives. An example of this process is found in the staff analysis of September 1983. In the event that some options may satisfy some objectives but not others, and those options are mutually exclusive, then the pros and cons and contribution of each to the objectives is analyzed on a case-by-case basis. The Department does not believe it is possible to develop an overall, generic ranking or point scoring system that is valid for all possible cases.

28. THERE HAVE BEEN SERIOUS PROBLEMS ASSOCIATED WITH THE DEPARTMENT'S PROCESSING OF PREFERENCE RIGHT LEASE APPLICATIONS ("PRLA'S").

- HOW MANY PRLA'S HAVE BEEN GRANTED OR DENIED IN THE LAST YEAR?

- WHAT TYPE OF ENVIRONMENTAL REVIEW IS THE DEPARTMENT ENGAGING IN WITH RESPECT TO THE PRLA'S IN ORDER TO ENSURE COMPLIANCE WITH THE COURT'S RULING IN NATURAL RESOURCES DEFENSE COUNCIL v. BERKLUND, 609 F.2d 553 (D.C. Cir. 1980)?

- WHEN WILL THE DEPARTMENT COMPLETE ITS PROCESSING OF THE PRLA'S?

No coal preference right leases have been issued and no coal PRLAs have been rejected during the last year. Since October 1984, however, 16 PRLAs have been voluntarily relinquished by the applicants.

In June 1983 BLM headquarters staff reviewed field-prepared environmental documents for compliance with the National Environmental Policy Act of 1969 and with the court's ruling in NRDC v. Berklund. The review resulted in a decision to prepare EISs on an application, area, or region-wide basis, as appropriate, for all but a few of the approximately 140 coal PRLAs then pending.

The review was conducted concurrently with the beginning of negotiations with several conservation groups over the adequacy of the Department's compliance with the court's order and opinion in NRDC v. Berklund. Although the negotiations covered many aspects of the Department's processing of the remaining PRLAs, the major issues discussed include the following:

1. depth of treatment in EISs of alternatives to issuing preference right leases, as described in NRDC v. BERKLUND;

2. form of mitigation required in lease terms, i.e., design criteria or performance standards;

3. degree of public review and participation in the major PRLA processing steps; and

4. how to comply with the language in the court opinion indicating that an EIS should contain estimated costs of compliance with recommended mitigation.

The Department and the conservation groups have reached a tentative agreement over what will constitute acceptable compliance with the court's order and opinion. If the Department of Justice determines that the agreement is acceptable, the agreement will be presented to the court as a proposed replacement order for the original order and opinion in NRDC v. Berklund.

29. ARE THERE CURRENTLY AREAS UNDER PRE-1976 LEASES THAT WOULD NOT BE LEASED FOR ENVIRONMENTAL OR OTHER LAND USE REASONS IF THE DECISION WERE BEING MADE TODAY?

The Department has not conducted any detailed analysis of pre-1976 coal leases to determine whether or not those coal leases would be issued today. Any statements that coal leases issued since 1976 are qualitatively better than those issued prior to 1976 are made based on the following logic: the years 1976 and 1977 saw the passage of three laws significantly affecting the leasing and management of Federal coal leases. The Federal Land Policy and Management Act states that it is the policy of the United States that public lands and resources are to be managed according to the principles of multiple use and sustained yield. The Federal Coal Leasing Amendments Act requires that all coal be leased competitively, that fair market value be obtained for all coal leased, and that no coal lease be issued until the land under lease has been evaluated in a land-use plan. The Surface Mining Control and Reclamation Act sets standards for the mining of Federal coal and for the reclamation of mined areas and gives the States a major enforcement role in overseeing coal mining and reclamation activities on split estate lands.

31 DOES THE DEPARTMENT HAVE SUGGESTIONS FOR OTHER LEGISLATIVE STEPS THAT COULD BE TAKEN TO PROVIDE AN INCENTIVE FOR THE TURNBACK OF OLD LEASES FOR LANDS THAT WOULD NOT BE LEASED TODAY? IF SO, PLEASE DESCRIBE.

All of the Department's recommendations for legislative action relative to providing an incentive for diligent production or turn back of old leases have been included in its statements to Congress on June 4 and November 8 of this year, and/or are contained in the September 1985 staff analysis.

32 DO LESSEES HOLDING PRE-1976 OLD COAL LEASES HAVE GRANDFATHER RIGHTS UNDER ENVIRONMENTAL LAWS MAKING PROVISIONS OF THOSE LAWS INAPPLICABLE? IF SO, PLEASE DESCRIBE.

Lessees holding pre-1976 Federal coal leases do not have grandfather rights under environmental laws. For pre as well as post-1976 Federal coal leases, an exploration plan can only be approved after compliance with the National Environmental Policy Act and other environmental laws (e.g., National Historic Preservation Act), as well as MLA requirements regarding operation and reclamation, codified at 43 CFR 3482.1(a). Similarly, a permit application can only be approved after compliance with NEPA and other environmental laws, as well as with the in-depth environmental requirements of the Surface Mining Control and Reclamation Act of 1977, codified at 30 CFR Chapter VII.

Some environmental statutes contain their own limitations, in order to avoid constitutional "takings" problems or to avoid destroying investment-backed expectations. For example, section 522(e) of the Surface Mining Act prohibits coal mining in certain areas "subject to valid existing rights," and the Federal lands review of section 522(b) of the Surface Mining Act does not apply to lands on which "substantial legal and financial commitments" were made prior to a certain date.

33. WHY DOES THE DEPARTMENT STATE IN ITS NOTICE OF FINAL GUIDELINES (50 FR 35125, 35126 (AUGUST 29, 1985))("SECTION 3 GUIDELINES") THAT SECTION 2(a)(2)(A) IS A "QUALIFICATION" PROVISION, RATHER THAN A "DILIGENCE" PROVISION?

- PLEASE SUMMARIZE THE PERTINENT PROVISIONS OF THE SECTION 3 GUIDELINES.

Please see Warner question 5 and response for brief outline of the guidelines. Section 2(a)(2)(A) is a "qualification" provision, affecting an entity's ability to acquire new Federal leases because Section 2(a)(2)(A) states, in part:

> "[t]he *Secretary shall not issue a lease* or leases . . . *to any person*, association, corporation . . . *where* any *such entity holds a lease* or leases issued by the United States *to coal* deposits *and has held such lease* or leases *for* a period of *ten years when such entity is not* . . . *producing coal from the lease* . . . *in commercial quantities*." (Emphasis added.)

The lessee must be *producing* in commercial quantities in order to qualify, under Section 2(a)(2)(A), to be issued any MLA lease. If a Federal coal lessee does not seek to qualify to be issued any MLA lease on or after August 4, 1986 (but decides rather to hold those Federal coal leases it currently holds), Section 2(a)(2)(A) does not compel that Federal coal lessee to do anything (i.e., produce). The pre-FCLAA lease that the lessee continues to hold is not being held in violation of its own terms and is not subject to diligence termination or cancellation until its own development/production obligation is effective. Post-FCLAA lease readjustment is the most common means by which pre-FCLAA leases become subject to FCLAA diligence. If the Federal coal lessee does seek to qualify to be issued any MLA lease on or after August 4, 1986, then each Federal coal lease that the current lessee holds and has held for 10 years must be *producing* (i.e., a continuing obligation) in commercial quantities whenever that lessee seeks to qualify for a new MLA lease.

Amended Section 7, unlike Section 3, is a "diligence" obligation to develop a specific Federal coal lease or lose that Federal coal lease. Amended Section 7 is not a provision to qualify to be issued any MLA lease (including coal) on or after August 4, 1986. Amended Section 7(a) provides for producing at the end of 10 years and amended Section 7(b) provides for diligent development and continued operation. If diligent development (defined by rgulations as having *produced* commercial quantities by the end of 10 years after becoming subject to amended Section 7) is not achieved for a lease, the lease is terminated by operation of law. If continued operation (defined by regulation as the *production* of not less than commercial quantities each year, or payment of advance royalty in lieu thereof, after achieving diligent development) is not maintained for a lease, the lease is subject to cancellation in a court of competent jurisdiction.

QUESTIONS SUBMITTED BY SENATOR WALLOP

1. WHAT, IF ANY, WOULD BE THE ADMINISTRATIVE DIFFICULTIES IN MANAGING AN ESCALATING HOLDING FEE AS PROPOSED IN S. 570 AND S. 372? WHAT TYPE OF ADMINISTRATIVE DIFFICULTIES WOULD THE DEPARTMENT FACE IF SUCH FEES WERE BASED ACCORDING TO THE VARIOUS COAL PRODUCING REGIONS?

The administrative difficulties in managing an escalating holding fee, of the sort proposed in S. 570 and S. 372 would be large relative to the flat rate fee recommended by the Department. Under the Department's proposal, a single rate would apply to the lease, for purposes of calculating the fee, independent of whether that lease were in the 11th, 12th or subsequent year of its term; and once applicable, would remain in effect at that rate independent of whether or not the lease was assigned. An escalating fee schedule, by contrast, would require that the Department track each lease individually and determine a different rate for each lease each year. There are currently in excess of 500 leases. Moreover, the problem is further complicated by the fact that the section 2(a)(2)(A) "clock" is reset whenever there is an arm's-length assignment. This would require a determination, on a case-by-case basis, of whether or not the assignment was truly arm's-length, or an assignment between affiliated organizations or organization under the "common control" of another entity. A reassignment to a prior holder of that same lease, even though arm's-length, would also require additional review to determine by how many increments the schedule rate should rise or fall as a result of the reassignment. Consequently, the administrative cost of either the S. 372 or the S. 570 proposed schedule would be significantly larger than the cost of the Department's proposal.

If flat, value-based fees were based on different levels according to the various coal producing regions, the administrative difficulty associated with regionalization would not be significant. All that would be required is an initial study to determine what regional variations, if any, would not already be captured in average reserve size or market price of produced coal. Our analysis suggests that regional variations not accounted for by these factors would likely be minor and it would therefore be unlikely that regionalization would be required.

Although there would be no significant additional difficulty if the escalating holding fee were regionalized, a non-value based (cents per ton) fee would, of necessity, have to be regionalized and would represent additional administrative costs over the value-based fee. In particular, a separate determination would be required for each region, with a detailed annual study and re-determination as a result of relative changes in market prices of the produced coal as well as regional production costs. To institute a non-value based (cents per ton) fee on an escalating basis would generate these difficulties in addition to the difficulties previously described with respect to an escalating value-based fee.

2. HAS THE DEPARTMENT GIVEN ANY THOUGHT TO HOW THESE HOLDING FEES, OR MINIMUM ROYALTY PAYMENT PROVISION WOULD BE DISTRIBUTED TO THE STATES?

Holding fees, or minimum royalty payments, would be distributed to the States exactly in the same way as production royalties. That is, the State would receive its share of the cash payment in the same manner as it receives its share of cash bonus and production royalty payments. When the lease enters production and production royalties are due, the lessee is permitted to credit preproduction or minimum royalties paid against production royalties due in excess of the minimum. The cash payment made by the lessee to the Department is then shared with the State in the same manner as in the past.

3. HAVE YOU SEEN THE OCTOBER 15 LETTER FROM GOVERNOR HERSCHLER AND THE GOVERNORS OF MONTANA, NEW MEXICO, NORTH DAKOTA AND UTAH? DOES THE DEPARTMENT HAVE AN OPINION OF THE PROPOSED AMENDMENT INSURING GREATER STATE PARTICIPATION IN FEDERAL LEASING DECISIONS? WHAT DO YOU THINK ABOUT CODIFYING THIS STATE ROLE AS THE AMENDMENT SUGGESTS?

We have seen the letter from the Governors of Wyoming, Montana, New Mexico, North Dakota, and Utah and we support active State participation in Federal coal leasing decisions. The chartering of the Federal-State Coal Advisory Board and the Regional Coal Teams (RCT) and the description of RCT duties in the Department's regulations are evidence of that commitment.

We do not, however, support establishing the States' role in mineral leasing statutes. We believe that regulations and charters give the States adequate assurance that their views and concerns will be seriously considered in the complex process leading to a decision on whether and how much coal to offer for lease. Establishment of the States' role in the statutes would not increase the States' role or the degree of consideration which their views are presently accorded.

Such statutory recognition of a specific interest group could lead to further statutory complications. State governments are not the only groups interested in or affected by coal leasing decisions. Other groups could justifiably press for statutory recognition equal to that of State governments. The resulting statutory amendments would lengthen the present statute without adding anything not already available to the States.

The Pittsburg & Midway Coal Mining Co.

R. M. Holston
PRESIDENT

1720 Writers Four
1720 South Bellaire
Denver, Colorado 80222

December 11, 1985

The Honorable John W. Warner
Chairman
Subcommittee on Natural Resources
Development and Production
United States Senate
Washington, D.C. 20510

Dear Senator Warner:

In response to your letter of November 19, 1985, attached please find answers to those questions directed to me following the recent coal leasing hearing conducted by your Subcommittee.

I was pleased to be a participant at the hearing and would welcome the opportunity to provide any further input that would be appropriate and helpful in this matter.

Very truly yours,

Dick Holston

RMH/wt

Attachment

QUESTIONS FOR PANEL I

Submitted by Senator Johnston

FOR THE RECORD

Senate Subcommittee on Natural Resources Development & Production

Answers Submitted by

The Pittsburg & Midway Coal Mining Company

Questions For First Five Witnesses

Question (1)

Assuming that Congress does not amend Section 2(a)(2)(A) of the Mineral Lands Leasing Act ("MLA"), to your knowledge, how will your company respond?

a - Will you relinquish noncomplying leases? Yes.

b - Will you assign noncomplying leases? We have no present plans to make assignments.

c - Will you bring noncomplying leases into production? Yes, if possible.

Question (2)

What do you think of suggestions that Section 2(a)(2)(A) requirements should be imposed prospectively on noncomplying leases obtained through assignment?

Answer (2)

The motivation of assignment of federal leases is unrelated to Section 2(a)(2)(A). That is, such assignments would take place for commercial reasons in arms-length transactions between unrelated parties. Therefore, the ten year clock should start again on the date of any such assignment.

Question (3)

What do you think is a reasonable time deadline for the diligent development of federal coal leases?

Answer (3)

Ten years is too short a time in today's business environment, particularly in view of the many regulatory requirements to bring a coal lease into production. Twenty years is more reasonable. Fifteen years would be a minimum. It is not possible to generalize, except to say that in most cases ten years is too short.

Question (4)

Section 2(a)(2)(A) of the MLA provides that lessees with nonproducing pre-1976 federal coal leases will be ineligible to obtain new leases for any minerals under the MLA if they do not bring their leases into production by August 4, 1986. S.372, S.570, and S.913 provide relief from this deadline. Some argue that these bills in effect penalize companies who have already taken steps to comply. What is your response to this argument?

Answer (4)

Compliance with Section 2(a)(2)(A) is solely a matter of market conditions. Those who have been fortunate enough to obtain sales commitments for the federal coal involved and bring the leases into production are the fortunate ones who are able to generate a reasonable rate of return on the investment. Those who have not been able to bring leases into production (i.e. obtain sales committments and comply with necessary regulatory requirements) are the ones who have nothing to show for their efforts and expenditures. They are the ones who are being penaltized by Section 2(a)(2)(A), rather than the other way around.

Question (5)

S.372 would allow lessees to acquire new federal coal leases upon the turnback of noncomplying pre-1976 leases with equal tonnage. The House bill also contains a turnback provision but includes a coal-region factor for use in determining how much coal must be turned back. Please elaborate on your views of these turnback provisions.

Answer (5)

Turnback is merely one option to consider in mitigating the harsh effects of Section 2(a)(2)(A). It is not the only option. No one option will be appropriate for all situations. Therefore, it would be sensible to provide more than one method of retaining eligibility to obtain new leases.

Question (6)

S.372 would allow lessees holding only one or two noncompliance leases to acquire new federal coal leases upon the payment of higher rent on the new coal deposits. What is your view on this proposal?

Answer (6)

Such an option (i.e. advance minimum royalties) is another possible approach to mitigating the negative effects of Section 2(a)(2)(A), but it should not be limited to any specific number of noncomplying leases.

Question (7)

Legislation providing for the payment of advance escalating royalties in lieu of production could require that lessees exercising this option must agree to the revision of their federal coal leases to reflect all statutory and regulatory requirements currently in effect. Could you support this proposal?

Answer (7)

Such an option should be limited to the advance royalty provisions and not expanded to include extraneous issues.

Question (8)

S.372 and S.570 both amend Section 7 of the MLA to allow lessees to continue to hold nonproducing leases for up to 20 years upon the payment of an advance escalating royalty in lieu of production for years 11 through 20. Please provide your views on this proposal.

Answer (8)

P&M agrees with this concept provided the advance royalty is set at a reasonable rate that is not so high as to create, in effect, a practical bar to holding such a lease for more than 10 years before it can be brought into commercial production. Secondly, the advance royalty should be recoupable in order to provide a further incentive to get the lease into production.

Question (9)

Do you think that such advance royalty payments should be recoupable against production royalties? In your view, would full recoupability impede the government's efforts to curtail speculative lease holding?

Answer (9)

Yes. (See Answer to Question (8) above.) Speculation in federal leases today is a red herring in that most leases are in the hands of legitimate coal producers. These producers have a strong financial incentive to get these leases into production as soon as possible.

Question (10)

S.570 would totally repeal the requirement that logical mining units (LMUs) be contiguous. A proposal before the House of Representatives (H.R. 1934) would allow noncontiguous areas to be incorporated into an LMU only if they are within reasonable proximity of each other and under the effective control of a single operator and incorporated into a single operation.

- Do you endorse either complete repeal or the House approach?

Answer (10)

P&M would prefer complete repeal of the contiguity restriction, but would accept the contiguity reform contained in H.R. 1934.

Question (11)

S.372 contains a provision defining "competitive bidding" as the receipt of bids by at least two bidders. Please comment on this method of ensuring that fair market value is obtained for federal coal.

Answer (11)

There may be valid reasons in certain cases for permitting only a single bid, although this would be a somewhat rare occurrence. A fair market value determination must consider all relevant factors, and should not arbitrarily exclude a single bid.

Question (12)

What steps do you think should be taken to ensure that fair market value is obtained for federal coal?

Answer (12)

An artificial and academic predetermination of market value is to exclude the market place. Fair market value is a relative determination between a buyer and a seller based on site specific terms and conditions.

Question (13)

Do you think that current market conditions support additional coal leasing at this time? Why or why not?

Answer (13)

Recognizing that there is considerable excess capacity throughout the coal fields in most areas at this time, the market place should establish the need for new leases that can timely be brought into production. The federal response should be flexible and responsive to site specific needs.

Questions For All Witnesses on Panel I

Question (1)

As you know, Senator McClure has introduced two amendments pertaining to Section 2(c) of the Mineral Leasing Act. One amendment would repeal that provision. The other apparently represents an effort to reach a compromise position on the issue. Could you support both amendments?

Answer (1)

No. P&M could not support either amendment.

Question (2)

Do you think that complete repeal of Section 2(c) would have anti-competitive effects?

Answer (2)

Absolutely. Repeal of Section 2(c) would create a situation in which the railroad would have a basic and very elementary conflict of interest in rate making between its own affiliate and other captive shippers. Second, and equally important, the railroad, having monopoly power over transportation of coal, would be able to allocate the rate of return between its transportation and mining affiliates to the competitive disadvantage of the commercial and captive shipper. For example, assume that a $5.00 freight rate would cover the railroad's cost of transportation and give it a fair rate of return for this service. Assume that also that $20.00 would be a fair f.o.b. price for coal sold either by the railroad's affiliate or a competing coal company. A railroad having a monopoly power over transportation would be able to raise its freight rate to say $10.00 and reduce the f.o.b. price of its affiliate's coal to $15.00. This would result in the same delivered price to a customer. It would make no difference to the railroad that the $15.00 f.o.b. price resulted in little or no return on investment in coal facilities, since an additional $5.00 would be earned on the freight element. However, this would raise the delivered price of a competing coal company's coal from $25.00 to $30.00, which would make its coal noncompetitive. If Section 2(c) is to be repealed or modified, protections against this kind of potential abuse of monopoly power must be built into the legislation.

Question (3)

Do you think we could alleviate concerns about these anti-competitive effects in the area of coal transportation by moving forward with coal slurry legislation?

Answer (3)

Transportation by coal slurry pipeline would be beneficial from a competitive transportation standpoint, but this form of transportation is not practical in many areas. It should be considered as a part of, but not the whole answer to, the captive shipper protection issue.

Question (4)

Senator McClure's Amendment No. 801 provides that railroads or affiliated companies leasing federal coal must comply with certain conditions (such as cooperative leasing and sharing of exploration data) only if the Secretary of the Interior finds that competition for the federal lease would be "substantially enhanced thereby." What criteria do you think the Secretary should apply in making the determination that competition would be "substantially enhanced?

- Can you think of circumstances under which competition would not be substantially enhanced by the sharing of data or the guarantee of cooperative leasing?

Answer (4)

The criteria to determine whether competition would be "substantially enhanced" are difficult to define, and this is one of the problems of the amendment proposed by Senator McClure. We cannot think of circumstances in which competition would not be substantially enhanced by the sharing of such data. In addition, the question of "substantially enhanced" competition involves more than the leasing issue (i.e. sharing of geologic data and cooperative leasing). The real concern is in providing protection and recourse in the area of rail rate discrimination, pricing abuses and monopoly power.

Question (5)

Amendment No. 801 employs the term "potential mining unit." What criteria do you think the Secretary of the Interior should apply in designating "potential mining units?"

- Should there be limintations on the size of the "potential mining units?" If so, what?

Answer (5)

The standards proposed by the Department of Interior in 1980 in its proposal for cooperative leasing (see 45 Federal Register page 85833, December 30, 1980) provide a possible framework for making such a determination. P&M believes that an important element of this proposal was that a "potential additional criterion would provide that the private cooperator (the railroad) could not participate in the sale as a bidder."

Questions for Coal Company Panelists

Question (1)

You are familiar with the amendments which Senator McClure has introduced on Section 2(c). I would like to hear from each of you about the provisions of these amendments acceptable to you; the provisions whiich are not acceptable and why?

Answer (1)

Outside the railroad "exclusive service area", the provisions of the amendment proposed by Senator McClure would be acceptable to P&M, if the leasing conditions in paragraph (i) and (ii) of Section 2(c)(2)(A) were made applicable in all cases.

However, inside the "exclusive service area", i.e. the area where a competing coal company is dependent on a railroad to transport its coal, the amendment proposed by Senator McClure does not provide necessary protections against the potential for abuse of the railroads' monopoly power over transportation. These concerns exist both in the areas of leasing and transportation.

Leasing - The conditions in Section 2(c)(2)(A)(i) and (ii) revised as suggested below, should be required in all cases. Making this information available to other bidders is bound to increase competition for the federal lease involved. A finding by the Secretary that competition for the federal lease would be "substantially enhanced thereby" should not be a precondition. That standard is vague and could be hard to define and enforce.

Subparagraph (ii) should be revised to provide that the railroad or its affiliate minerals company will offer for lease the land grant coal deposits owned by the railroad or affiliated company in the potential mining unit but that the railroad or affiliate company can not "participate in the sale as a bidder." This was one of the criteria suggested by the Department of Interior in its Cooperative Coal Leasing Proposal in 1980. (See 45 Federal Register p. 85833, at 85834, Attachment A.) This would faciliate development of these coal resources, provide a fair return to the railroad with no cost or investment by it in developing or producing these reserves, and minimize the clear conflict of interest which would result if the railroad and its controlled affiliate were allowed to compete with an independent coal company over whom the railroad exercises monopoly transportation power.

Subsection 2(B) should be deleted. Conditions (i) and (ii) as revised, of Section 2(c)(2)(A) should apply in all cases. It would be relatively easy for a railroad to arrange its affairs in such a manner to avoid these conditions if subsection (B) is left in the statute.

Transportation - Section 4 of the amendment proposed by Senator McClure, which attempts to address the transportation issue, fails to provide the basic protections needed by a captive shipper in several respects.

First, it involves only after the fact potential disclosure of contracts, and fails to provide any protection or relief to a captive shipper. It gives a competing coal producer the right to file a complaint with the DOI, if it can allege (1) that the railroad's transportation contract is "in violation of law" and (2) that it prevented the independent coal producer from selling its coal to the purchaser. This provision would provide essentially no protection at all to the captive shipper. As the ICC testified before the Linowes Commission, a captive shipper would have no recourse to the ICC even if the railroad's freight contracts discriminated in favor of its minerals affiliate. (See Attachment B, at p.9.) Further, since railroads are exempt or immune from private actions by injured competitors under present antitrust laws (e.g. the Sherman Act, the Federal Trade Commission Act and the provisions of the Clayton Act providing a private remedy to competitors) these laws would provide no real protection against unfair competition by a railroad which holds monopoly transportation power over a competing coal company. (See Attachment C.) This is one reason why the provision for review of proposed leases by the Department of Justice under Section 15 of the Federal Coal Leasing Amendments Act of 1976 would provide little protection to a competing coal company in the railroad's exclusive service area if Section 2(c) is repealed or amended as is proposed.

Second, a competing coal company would not know whether the terms offered by a railroad and its coal producing affiliate "prevented complainant from selling its coal to the purchaser" in lieu of the coal offered by the railroad affiliate without seeing the contracts involved. In part the independent coal company might not even know the terms offered by a railroad for transportation of coal produced by it to a customer. By the time the proposed procedure results in the disclosure of the relevant facts to a competing coal company the damage will have been done. Even if a theoretical, after the fact remedy were available, as a practical matter the contract would have been lost.

Any statutory modification to Section 2(c) must include protections against the possibility of such unfair competitive practices by a railroad which would be put in the position of competing against another coal company over whom it holds monopoly transportation power.

Question (2)

Recognizing that the rail affiliates are today willing to accept 2(c) modification rather than outright repeal; accept for discussion that coal slurry is not tradeable with the railroads, and accept that the Staggers Act is not a coal leasing issue nor the jurisdiction of this Committee, what 2(c) provisions or modifications are acceptable to your company?

Answer (2)

This question is not easy to answer given the constraints involved, since transportation and antitrust issues are critical considerations in addressing the Section 2(c) issue. However, it might be possible for the DOI to protect captive shippers in this situation if it is given sufficient regulatory powers. For example, DOI could be required, prior to offering federal coal for sale, lease, or exchange to a railroad or its minerals affiliate, to determine if the proposed acquisition by the railroad or its affiliate would put the railroad and its affiliate in actual or potential competition with a coal company in an "exclusive service area." (See our answer to question 3(a) below for a definition of "exclusive service area.") If DOI made such a finding, that railroad (and only that railroad) would be precluded from bidding for or acquiring any interest in the federal coal reserves in question unless it agreed to a cooperative lease sale arrangement similar to that proposed by the DOI in December of 1980. (See Vol. 45 Federal Register pages 85833-85836, Attachment A.) The terms of the lease sale should provide, as suggested by DOI in the 1980 Proposal that the private cooperator (the railroad or its mineral affiliate) "could not participate in the sale as a bidder". In this arrangement the railroad would still receive a fair return for its coal reserves, since it would receive the agreed share of any bonus and royalties and would be freed from all development or operating costs. However, the potential for abuse by the railroad by its monopoly power over transportation would be greatly reduced, since the railroad would not be actively involved in producing and selling the coal in question.

A possible alternative, if the DOI were to determine that the only way to achieve a competitive lease sale would be to permit the railroad to bid for or otherwise acquire an operating interest in federal coal reserves, would be to permit the railroad to bid at the cooperative lease sale, if it agreed in advance to publish uniform terms and conditions, including rail rates for transportation of coal which would apply in the exclusive service area to its own affiliate and any other coal company operating in that area. These rates or charges could not exceed cost including a reasonable rate of return on the investment involved. The DOI, with the advice and assistance of the ICC, would be empowered to review and enforce these provisions. Violations could result in suspension or termination of the right to produce and sell the federal coal involved. An agrieved private party would have the right to initiate an action for damages or injunctive relief or to cause DOI to initiate an investigation and possible enforcement action.

As an alternative, a railroad could be required to grant "trackage rights" in its "exclusive service area" to a competing coal company or another railroad designated by it or its purchaser. These mechanisms would reduce the possibility for a railroad to use its monopoly power to raise transportation rates either to the customers of a competing railroad or to all customers with a corresponding reduction in the f.o.b. price of its affiliate's coal.

Question (3)

As described in the McClure amendment modifying Section 2(c), would you agree that allowing railroad coal company affiliates to hold and produce from Federal coal leases in any area that offers head-to-head competitive rail service lacks the controversy of an outright repeal of Section 2(c), and therefore would be acceptable to you?

Answer (3)

Although it does not appear to us to be described in the McClure Amendment modifying Section 2(c), P&M agrees that allowing railroad company affiliates to hold and produce from federal coal leases in an area that offers head-to-head competitive rail service lacks the controversy of an outright repeal of Section 2(c), and therefore would be acceptable to P&M, if it can be clearly demonstrated that such competition exists. In this situation the provisions of paragraphs (i) and (ii) of subsection 2(c)(2)(A) (relating to availability of exploration data and cooperative leasing), of the McClure amendment should provide sufficient protections and incentives to foster competition at the lease sale.

Question (4)

Would you be opposed to a railroad coal affiliate owning and producing coal from Federal coal leases in those areas where competitive rail transportation exists?

Answer (4)

See the answer to Question (3).

Questions Submitted for Mr. Holsten - For the Record

Question (1)

Your written statement indicates that it is given on behalf of the National Coal Association, the Mining and Reclamation Council and the American Mining Congress. Does the American Mining Congress support the position you've articulated on repeal of 2(c)?

Answer (1)

My oral statement qualified my remarks to the extent that it acknowledged that certain members of NCA and AMC represent railroad interests and my views and statements therefore did not necessarily represent those of the entire membership of all the trade associations. I understand that AMC has not taken a position either for or against repeal of Section 2(c).

Question (2)

With respect to your basic contention that the railroads would use their transportation monopoly to discriminate in favor of their coal affiliates, I am advised by my staff that this argument was addressed and refuted by Assistant Attorney General William F. Baxter in his testimony before the Linowes Commission in November 1983 recommending repeal of 2(c). Please comment on that.

Answer (2)

Mr. Baxter, in his testimony before the Linowes Commission, did not address the problem we are concerned about, namely the power to raise transportation rates and lower the f.o.b. price for the railroad's affiliate coal to gain an unfair competitive advantage over an independent coal company dependent upon the railroad to transport its coal. His testimony assumed that the railroad would not be able to raise its freight rates above a true competitive level, but conceded that this assumption might be inaccurate:

> "It is possible that the rate increases that have followed the passage of the Staggers Act were sufficient to eliminate regulation as an effective constraint on rates ..." (F.N. 2 page 6)

It is our belief, based both on the experience of captive shippers in certain areas and the testimony of the ICC before the Linowes Commission, that there is in fact no effective restraint on the ability of a railroad having monopoly power over transportation of a competitor's coal to raise its rates in a way that results in unfair competition vis-a-vis that competitor.

Question (3)

Throughout your statement, you assert that railroads exercise monopoly power over rates and service in their exclusive service areas.

a. Please define what you mean by "exclusive service area" with respect to the Burlington Northern Railroad, Santa Fe Railway, Southern Pacific Transportation Company and Union Pacific Railroad, respectively.

b. Please provide the committee with the basis for your contention that each of these railroads exercises monopoly power, including any economic studies that have addressed this question.

Answer (3)

a. "Exclusive service area" would include any area in which a coal mine would be solely dependent on a single railroad for competitive transportation of all or a significant part of its coal to market, i.e. where there is no other realistic competitive means of transport.

b. We do not base our assertion on any academic economic studies. The market determines when monopoly power can exist simply by the fact that there is no economically competitive alternative to rail transportation for an individual or group of mines along that railroad's right of way or in its exclusive service area.

Question (4)

Do you believe that major oil companies should be able to integrate themselves in all aspects of the petroleum production, refining, processing and marketing functions of the business?

a. If so, doesn't the possibility exist that they could unfairly allocate profits between these various segments, as you have hypothesized might occur if the coal production and transportation functions were placed under the same corporate umbrella?

b. If not, why not?

c. Are there any statutory constraints directed at this potential shifting of profits between the various functions controlled by an integrated oil company? If there are not, do you believe there should be?

d. Why is there no "answer", as you have said, to the possibility of "unfair allocation".

Answer (4)

We are concerned about vertical integration only where one of the companies involved holds monopoly power, for example in the case of a railroad and its mineral affiliate being allowed to compete in an area where the railroad has monopoly power over transportation of coal produced in that area by an independent coal company. It is the obvious potential for unfair competition resulting from this monopoly power that gives us great cause for concern, not the vertical integration by itself of a railroad and a minerals subsidiary. Outside the area where the railroad exercises this monopoly power over transportation we have no problem with this vertical integration. In cases where a railroad has this monopoly power, however, it is very difficult to protect against the possibility of unfair competition. Nevertheless, there may be legislative solutions that could alleviate this problem, as we suggest in our answer to question number 2 of "Questions for Coal Company Panelists."

Question (5)

Did the National Coal Association provide the Linowes Commission with any economic or legal analyses or any other substantiation of its argument regarding the potential for discriminatory treatment by a railroad in favor of its coal affiliate during the Commission's deliberations on repeal of 2(c)?

Answer (5)

We understand there were no economic or legal analyses, as such.

Question (6)

With respect to your assertion that the railroad coal affiliates have been sitting around waiting for repeal of 2(c) and not leasing their coal, doesn't your company hold a lease on Santa Fe coal as part of your McKinley Mine in New Mexico?

Answer (6)

P&M obtained several Sante Fe leases back in the early 1960's. That same mechanism would allow railroad land grant coal rights to be brought into production today without the potential of monopoly abuse that would exist if the railroad were allowed to produce and market federal coal in its exclusive service area in competition with another coal company over whom the railroad exercises monopoly transportation power.

Question (7)

You indicate that in your negotiations with the railroad coal affiliates they did not propose any new remedies for the discrimination concerns you expressed beyond those available under the anti-trust laws and the Interstate Commerce Act.

a. Did you propose any new remedies to them?

b. Do you have any to propose to the Committee?

Answer (7)

We discussed certain leasing issues with the railroad coal affiliates. In the course of these discussions it became apparent that the issue was more than just a leasing issue, and that important transportation issues would have to be addressed. Accordingly we requested a meeting with the railroads themselves to discuss these transportation issues. To date the request for such a meeting has not been granted. We would be happy to discuss these transportation issues with the railroads themselves and/or with the Committee. We made suggestions for resolving this issue in our written testimony, and some of those suggestions are repeated in this submission.

Question (8)

During the last two years, did Pittsburg & Midway Coal Mining Company renegotiate its contract to supply coal from its McKinley Mine in New Mexico to Salt River Project's Coronado, Arizona generating station? If so,

a. Under the new contractual arrangement, is the price of the coal higher or lower than what Pittsburg and Midway was receiving pursuant to its earlier arrangement with the Salt River Project?

b. If lower, to what extent did new competition from SF Coal's Lee Ranch Mine cause it to lower its price?

c. Which railroad transports the coal sold under this contract to the generating station?

d. If there is a contract covering the transportation of this coal, who are the parties to the contract and when was it entered into?

Answer (8)

Yes. P&M renegotiated its existing long term contract with the Salt River Project in early 1984. In return for additional tonnage from the McKinley Mine to the Coronado Station, P&M offered Salt River a moderate reduction in price. This reduction was acceptable to P&M in view of the additional volume. P&M is unaware of the competitive impact, if any, of the Lee Ranch Mine since we have no way of knowing the details of any offers made to Salt River by the Sante Fe. Likewise, P&M had no direct involvement in the transportation arrangement rates on the moving of the McKinley coal to Coronado as this is the responsibility of Salt River. The Santa Fe Railroad serves the McKinley Mine and transports P&M's coal to the utility at Coronado.

Question (9)

Does Pittsburg & Midway also supply spot coal from its McKinley Mine to Salt River Project's Coronado, Arizona generating station? If so,

a. When did Pittsburg & Midway begin supplying this coal?

b. Is the price at which it is supplying the coal higher or lower than the price at which it supplies spot coal to Arizona Public Service Company's Cholla, Arizona generating station? If lower, to what extent did new competition from SF Coal's Lee Ranch Mine cause it to sell the spot coal at the lower price?

c. Which railroad transports the coal to the generating station?

d. Please describe the arrangement under which the coal is transported to the generating station?

Answer (9)

P&M supplies no spot coal to Salt River.

Additional Questions for Mr. Holsten - For the Record

Question (1)

You express concern about the potential of the delivered price of coal to be "unfairly" established at a low level, if both the carrier and the producer are jointly owned. Doesn't the same potential exist for a non-affiliated carrier and producer, to price at an "unfairly" low rate when pricing can be based on incremental costs by both parties and the transportation provided under a specific contract?

Answer (1)

My concern does not include the unrelated pricing policies of a non-affiliated producer and common carrier railroad. These are independent management judgments. The problem I am concerned about is the potential for profit allocations between an affiliated producer and railroad wherein an internal decision can be made to inflate the rate rate available both to the non-affiliated and affiliated producers, thereby alowing the affiliated producer to unfairly reduce the price at which it markets its coal.

Question (2)

It has been said that preventing Section 2(c) repeal is a higher economic/business priority to certain oil companies than the repeal of Section 3. Would you please specifically identify which company or companies feel that preventing the reform of Section 2(c) is a higher economic/business priority than the repeal of Section 3?

Answer (2)

I am unaware of the "economic/business" priorities of oil companies in this matter.

Question (3)

In your November 8, 1985 testimony before the Committee, you endorsed amending Section 2(c) to allow rail affiliates to lease and hold federal coal resources outside their "exclusive service area." Would you please define for the record the term "exclusive service area."

Answer (3)

A railroad's "exclusive service area" would include any area along or in reasonable proximity to that railroad's right-of-way in which a coal mine is solely dependent on that carrier for competitive transportation to market.

Question (4)

Senator Ford asked the members of the coal industry on Panel I whether the "agricultural shippers" provision of the Staggers Act would be helpful. Was this provision presented to your side of the industry by the rail affiliates during negotiations under the auspicies of the AMC or the ad hoc group you chaired? If so, did the industry respond?

Answer (4)

Specifically I am not familiar with the "agricultural shippers" provision of the Staggers Act nor do I have any firsthand knowledge of the details of the railroads discussion with AMC. It is my understanding that the railroads' proposal to the ad hoc group I am involved with was similar or possibly identical to the AMC proposal. We did respond that part of the proposal dealing with rate verification did not resolve our concerns since the verification procedure was after the fact, i.e. after binding sales commitments have been made by the rail affiliated producer. There has been no further suggestion made by the railroads or their affiliates.

Question (5)

Does your parent company support the proposals you made in your November 8, 1985 statement before this committee for amending the Staggers Rail Act?

Answer (5)

Within the corporate organization, matters pertaining to coal have been delegated to The Pittsburg & Midway Coal Mining Co., and here strategic and policy matters such as included in my November 8 remarks are the responsibility of myself as chief executive officer.

ATTACHMENT "C"

RE: Application of the Antitrust Laws to the Railroad Industry

Attached is a copy of testimony given before the Senate Judiciary Committee on September 24, 1985, by James A. Calderwood, Esquire, a Washington attorney who was formerly with the Antitrust Division of the Department of Justice. This testimony makes the point that under present law the railroads enjoy broad exemptions from application of the antitrust laws. Therefore, the antitrust laws would not be an effective check on the obvious potential for abuse by a railroad if it is permitted to acquire federal coal properties and to compete against independent coal companies who are dependent on the railroad for transportation of their coal. This is the most common situation today in the areas where the railroads seek to acquire federal coal reserves.

The broad exemption of railroads from application of the antitrust laws must be narrowed, or other protections enacted, if Section 2(c) of the Mineral Leasing Act is amended to permit railroads or their minerals affiliates to acquire and operate federal coal reserves. At the time most of the statutory exemptions were enacted or the cases granting exemptions were decided, the railroads were subject to extensive regulation by the ICC. Also, Section 2(c) was designed to prevent railroads from being in the dual position of a seller of coal and a tranporter of its own and its competitors' coal, because of the obvious conflicts of interest and opportunities for unfair competition involved. The Staggers Act, as interpreted and implemented by the ICC, has seriously eroded the regulatory power and supervision of the ICC over rail freight rates. Amendment or repeal of Section 2(c), without accompaning legislative protections against the possibility of abuse of the railroads' monopoly power over transportation, would effectively put the railroads in the position of being able to use this monopoly power with essentially no private recourse for an injured competitor under the antitrust laws.

The applicability of the present antitrust laws to railroads can be briefly summarized as follows:

Sherman Act

- Section 1: Prohibits agreements in restraint of trade. Under this section, as interpreted by the U.S. Supreme Court, an agreement between a railroad and its wholly owned minerals subsidiary would not be sufficient to invoke Section 1 of this Act, since a parent corporation and its wholly owned subsidiary are legally incapable of conspiring with each other under Section 1 of the Sherman Act.
- Section 2: Prohibits monopolies or an attempt to monopolize. Under the Keogh doctrine, a railroad would be immune from a damage award under both Sections 1 & 2 of the Sherman Act on the theory that this would frustrate the rate making jurisdiction of the ICC.* This bars private antitrust damage suits.

Clayton Act

- Section 7: Prohibits anti-competitive mergers. This Section would not apply except in a merger situation. In addition, it exempts from its application mergers subject to ICC jurisdiction, which presently includes railroad mergers.
- Section 16: Permits private suits for injunctive relief under the antitrust laws, except a suit against a common carrier (e.g. a railroad).

---

* Whether this doctrine remains viable after enactment of the Staggers Act is an open question; the Supreme Court has agreed to hear a case involving a related issue but this issue has not yet been finally decided.

Robinson-Patman Act

- Prohibits price discrimination, but applies only to the sale of commodities, and is therefore inapplicable to transportation services.

Federal Trade Commission Act

- Prohibits "unfair methods of competition" and "unfair or deceptive acts or practices" effecting commerce, and directs the FTC to prevent any person or corporation from using such unfair methods of competition or unfair practices, except (among others) common carriers (e.g. railroads).

Clearly, any consideration by Congress of an amendment to Section 2(c) which would permit railroads (or their minerals subsidiaries) to compete against other coal companies over which they have monopoly transportation power, must also include a re-examination and reconsideration of these antitrust exemptions for railroads, particularly in light of the post-Staggers de facto deregulation of railroad transportation rates. Effective protection against the potential misuse of this monopoly power must be incorporated into any such legislation, or must be accompanied by protective changes in the Staggers Act or the antitrust laws.

al Institutes of Health, Bethesda,
and 20205.

S. Fredrickson,

National Institutes of Health.

ogue of Federal Domestic Assistance
Number 13.393, Cancer Cause and
tion Research)

[illegible] Filed 12-29-80; 8:45 am]

CODE 4110-08-M

ARTMENT OF THE INTERIOR

ge Conservation and Recreation

nal Register of Historic Places; ng Nominations

nications for the following ties being considered for listing in National Register were received by Heritage Conservation and ation Service before December 19, Pursuant to § 1202.13 of 36 CFR 1201, written comments concerning significance of these properties the National Register criteria for ation may be forwarded to the onal Register, Heritage ervation and Recreation Service, Department of the Interior, shington, DC 20243. Written ments should be submitted by uary 14, 1981.

ald M. Greenberg,

Chief, National Register Division.

ZONA

ona County

n, Frankenberg House, 129 W. versity Dr.

LIFORNIA

eda County

keley, *U.S. Post Office,* 2000 Milvia St.

Angeles County

os Angeles, *U.S. Post Office and Courthouse,* 312 N. Spring St.

ta Barbara County

nta Barbara, *Santa Barbara County Courthouse,* 1100 Anacapa St.

[illegible] County

vada City vicinity, *Foote's Crossing Road,* Tahoe National Forest (also in Nevada County)

City, *Kentucky Mine,* CA 49

LORADO

[illegible] County

[illegible] vicinity, *Alpine Tunnel Historic District*

[illegible] County

rrison vicinity, *Peterson House (Tioga Ranch),* E of Morrison on Morrison Rd.

GEORGIA

Heard County

Franklin, *Heard County Jail,* Court Sq. and Shady Lane

NEW HAMPSHIRE

Coos County

Bretton Woods vicinity, *Fabyan Guard Station,* NW of Bretton Woods on Cherry Mountain Rd.

OHIO

Lucas County

Neapolis vicinity, *Providence Site (33–Lu–150),* S of Neapolis in Providence Metropolitan Park

Montgomery County

Trotwood, *Trotwood Railroad Station and Depot,* 2 W. Main St.

Adair County

Westville vicinity, *Alberty Chapel Cemetery,* SE of Westville

Creek County

Drumright, *Washington School,* 214 W. Federal St.

Garfield County

Enid, *Government Springs,* 4th St. and East Pk.

Okmulgee County

Henryetta vicinity, *Wilson School,* NW of Henryetta

OREGON

Umatilla County

Umatilla vicinity, *Umatilla (35 UM 1),* N of Umatilla

UTAH

Salt Lake County

Salt Lake City, *Utah State Fair Grounds,* 10th W. and N. Temple Sts.

WISCONSIN

Belleville, *Library Park,* Bounded by vine, Main, Park and Pearl Sts.

Walworth County

Delavan vicinity, *Mile Long Site,* S of Delavan (boundary decrease)

[FR Doc. 80-40300 Filed 12-29-80; 8:45 am]

BILLING CODE 4310-03-M

Bureau of Land Management

Federal-Private Cooperative Coal Leasing Proposal

AGENCY: Bureau of Land Management, Interior.

ACTION: Request for public comment on the Federal-private cooperative coal leasing proposal.

SUMMARY: Under the Mineral Leasing Act of 1920, as amended, the Secretary of the Interior is responsible for managing a program for the competitive leasing of Federal coal. In addition, he is to ensure that Federal coal is leased at its fair market value. Considerations for ensuring receipt of fair market value were studied by a Department of the Interior task force that concluded its efforts in the spring of 1980.

One of the recommendations of the Fair Market Value Task Force on Federal coal leases was to enhance Federal coal sale competition by working cooperatively with private coal owners to jointly market coal from potential logical mining units comprised of both Federal and private coal. A cooperative leasing procedure would be of significant benefit to the systematic development of private-Federal mixed ownership coal, especially checkerboard coal. Acting on the task force's recommendation, a working group within the Department has designed a proposed method for cooperative leasing which it hopes to apply in the October 1981 lease sale in the Green River-Hams Fork Federal Coal Region in northwest Colorado and southwest Wyoming. This method and its benefits, costs, and potential problems are described in the enclosed appendix. The two suitable tracts for cooperative leasing, Red Rim and China Butte, are juxtaposed with the lands owned by Rocky Mountain Energy Company. Rocky Mountain Energy Company and the Department have already conducted preliminary discussions concerning the possibility of cooperative leasing on these tracts.

The public is invited to comment on the validity of this specific cooperative leasing proposal, as well as the concept of cooperative leasing itself; to suggest modifications to the proposed methods; or to suggest other means to accomplish the same ends. The next step in the process, following analysis of comments, will be to enter into formal negotiations with Rocky Mountain Energy Company over cooperative leasing.

DATES: Written comments will be received on or before January 29, 1981.

ADDRESS: Send comments to Director (160), Bureau of Land Management, 18th & C Streets, N.W. Washington, D.C. 20240.

FOR FURTHER INFORMATION CONTACT: Ryan Dudley, Office of Coal Management, Bureau of Land Management, (202) 343–4537.

Dated: December 22, 1980.

Ed Hastey,

Associate Director, Bureau of Land Management.

Appendix—Federal-Private Cooperative Coal Leasing Proposal

I. Introduction

This country has vast reserves of coal. Its coal deposits are widely distributed and vary greatly in quality and value. Much of this coal is privately owned and with a few notable exceptions, namely certain concentrated railroad holdings, private ownership is widely dispersed. The States also own significant reserves. However, the most significant single owner of U.S. coal reserves is the United States Government and most of these reserves are located in the West.

The "checkerboard" pattern of ownership occurs in some of the richest coal fields in the West, such as the Green River Basin in Wyoming. This pattern may have a significant effect on the development of U.S. coal and competition for Federal coal leases. Checkerboarding occurs where alternate sections of land are owned by the United States and a private landowner or corporation, most often a railroad company or its affiliate. Coal deposits in many areas of these checkerboard regions underlie a number of sections of land owned by the government and private parties, making efficient development of the deposit as a single economic unit difficult. Unless these coal deposits are controlled through lease or ownership by a single operator, the coal deposit may be mined piecemeal in a manner that is neither efficient nor economical. When a coal deposit underlies unleased Federal lands and adjoining privately owned land, the competitive interest in the unleased Federal coal may also be diminished because prospective Federal lessees may be uncertain of their ability to arrive at satisfactory contractual agreements with the adjoining private owner or owners. Also, the time needed to bring a Federal lease into production in a checkerboard area may be significantly lengthened by the extra time needed for land assembly. In short, the checkerboard pattern of ownership may constitute a significant impediment to efficient mining of coal in the checkerboard, may reduce the value of any Federal lease to a potential bidder, and may reduce competition as well. The total effect may be inefficient mining of the coal, a loss in the Department's effectiveness in meeting leasing targets, and a significant reduction in Federal leasing revenues.

II. The Concept of Cooperative Leasing

The most serious problems created by checkerboarding may be overcome if it is possible to obtain and package all the rights that are necessary for efficient mining of a potential logical mining unit prior to the sale so that the entire package can be put up for bid. Competition could then assure that the public receives a *fair return* from the sale of the Federal coal. Efficient development of the coal resources would also be promoted, many costly uncertainties would be eliminated, and, if the packaging can be done cheaply, there may be significant savings in transaction costs. Therefore, it is important to explore the possibility of packaging Federal and private rights, which we shall refer to as "cooperative leasing," prior to leasing Federal deposits. If cooperative leasing is adopted, the winning bidder for a Federal lease will have the opportunity to acquire all the public and private property rights that are required for efficient mining. If packaging takes place prior to auction, it eliminates the most serious problems presented by a checkerboard. There are a number of important practical and theoretical questions associated with the concept of cooperative leasing. For example, one question is what legal or procedural means should be used to effect the cooperation? This is important because different procedures have very different implications for risk bearing, capital requirements, and the need for revenue sharing rules, etc. A second question is which party should initiate the cooperative agreement: the government, one of the private parties owning rights that would be included in the package, or a third party acting as a broker? A third question is whether a workable and fair rule for sharing revenues can be defined and implemented. The list of possible questions regarding the hows and wherefores of cooperative leasing is a long one. The department believes these questions can best be answered by the experience gained through attempting to conduct a cooperative lease sale. The following discussion outlines the procedure the Department might follow for such a trial run.

III. Current Proposal for Cooperative Leasing

Even though several Department studies have been done relating to the question of cooperative leasing, a great many technical issues still need resolution for it to become a reality. Up until now, no single preferred method has been developed by, or presented to, the Department. This proposal came about as a result of the Secretary's commitment that the Department make every attempt to find a feasible way to include one "unitized" tract in the first Green River-Hams Fork regional lease sale in 1981.

As a result of this commitment, a task group set up under the guidance of the Office of Coal Leasing, Planning and Coordination has selected a workable method from among all the prior proposals. The task force has rejected, as far as this first attempt is concerned, all methods of cooperative leasing which do not meet certain, basic criteria. These criteria include the following:

1. The proposal must provide for *pre-sale* packaging of Federal and private coal. This has no applicable precedents in Federal mineral leasing. The unitization procedures common to oil and gas are *post-sale* procedures and do not solve the problems in holding a competitive sale in a checkerboard area.

2. Any lease terms affecting the value of the lease must be the same in both the public and private leases.

3. The Department has no legal authority for compulsory pre-sale packaging of Federal and private tracts nor is it clear that such authority would be purely beneficial. Consequently, we must rely upon a voluntary agreement between the Department and willing private coal owners.

4. The proposal must be in accord with all current laws and regulations governing Federal coal leasing.

5. A potential additional criterion would provide that the private cooperator could not participate in the sale as a bidder.

With these criteria in mind, the task group sifted through the numerous theoretical proposals advanced by earlier studies. The proposal presented here is one that appeared to be both feasible and relatively simple to execute. No doubt other methods also exist which meet the criteria. The task group and the Office of Coal Leasing are anxious to receive any and all such proposals for consideration. If other methods turn out to be clearly more workable, they will be adopted. At this time, however, the need is to bring the cooperative leasing concept out of the realm of theory and into a single, concrete, and workable proposal.

A. Leasing with checkerboard ownership.—In this proposal, we focus on specific procedures for cooperative leasing in the one case of most widespread importance, namely, checkerboard ownership. Here the government and a private owner own alternate sections of land and [illegible]

...er in a two-party bargaining situation.

In the case of a potential logical mining unit (LMU) composed of Federal coal and private coal controlled by one party, the policy objectives should be to form the potential LMU at minimum cost to society and to develop procedures that allow the public to recieve a fair share of the LMU rents. Transaction costs of assembly in checkerboard potential LMU may be high both for the Department and for its future lessees. For this reason, bidders other than the private owner or a party that had already reached an understanding with the private owner might ordinarily be discouraged from bidding on the unconsolidated tract.

The bilateral situation requires that the government have the pre-sale cooperation of the private owner in order to reach agreement that his property will be put up as part of a potential logical mining unit and sold at the same time as the Federal property on specified terms. The winning bidder would thereby acquire at one sale a tract of land that can be approved and operated as an LMU without costly effort on his part.

As part of this agreement, the government and the private owner must agree on a rule by which they will split the revenues from the LMU. Because of the efficiencies of scale, the LMU will be worth substantially more than the worth of either party's tracts individually. To encourage private sector cooperation, the government should attempt to devise a sharing rule that would split the gains from forming an LMU in a way roughly proportional to each party's interests in that unit.

While the initial costs of bargaining between the government and the private owner might be substantial, once the basis for an agreement has been reached within a coal field where checkerboarding occurs, costs would be reduced for future bargaining to form additional public-private LMUs. In other words, once the basis of agreement has been established, it would likely extend without major changes to all properties and all potential LMUs in the checkerboard region. Therefore, the potential exists for a savings in the future costs associated with attempting to assemble preliminary LMUs.

In practice, the simplest way to administer cooperative leasing in the checkerboard case might be to have the private owner and the government agree on a sharing rule and then have the private owner lease to the government with written permission to sublease. Then, the entire potential logical mining unit could be offered by the government on a competitive basis with the revenues from the lease being divided according to the preagreed sharing rule. This arrangement, however, might require legislation giving the Department of the Interior authority to lease privately owned land. An alternative arrangement would be to have competitors bid separately on the total mining unit as two individual mining units in a simultaneous sale. Here an agreement would be needed whereby the winning bidder must lease the government's land and the private land separately, but at or above a price determined by the prespecified sharing rule and the level of the winning bid for the total potential LMU. Simultaneous auctions appear too cumbersome, however. The method proposed in the following section is to conduct a single auction for the Federal coal land. The private owner would not assign any rights to the Federal Government, but would, instead, agree to offer his coal lease to the successful bidder on the Federal tract upon terms which he and the Federal Government would agree upon. For the present, sales would proceed through the variable bonus/fixed royalty bidding system. Whether deferred bonuses would be used has been decided.

B. *Federal-private cooperative coal leasing proposal.*—The task force has labeled its proposal for pre-sale coal lease packaging "Federal-Private Cooperative Coal Leasing." The intent of this proposal is to provide an opportunity for any interested party, to obtain at the same time separate leases for both Federal and private coal necessary for an efficient mining operation in a checkerboard area. The sale of the Federal coal lease will be conducted in the usual and customary manner with the winning bidder obtaining the Federal lease. By means of a pre-sale cooperative leasing agreement, the winning bidder for Federal coal would be given the opportunity also to buy the private coal.

To accomplish this, the Department would enter into a presale cooperative agreement with the private coal owner. The agreement would provide that the private coal owner would sell a private coal lease at the same time as the Federal sale to the winning bidder in the Federal sale. The agreement would also contain a key provision to fix the share of the total bonus going to the private coal owner and the amount going to the Federal Government. This allows each bidder to calculate the total amount to be spent for the entire mining unit, both Federal and private coal.

The factor referred to will be called the "Federal-Private Bid Ratio." This is simply a pre-sale announced fixed ratio between the bid on the Federal lease and the selling price on the private lease which each bidder for the Federal lease is required to adhere to. This ratio will be set by agreement between the Department and the private coal owner and will be based upon economic evaluations of the tracts and arrived at through bilateral negotiations. The minimum acceptable bid for the Federal lease and its concomitant private selling price would also be set at this ratio.

Any increase in the bid for the Federal lease above the minimum will also require raising the selling price for the private lease in order to keep the ratio constant. Thus, the high bidder in the Federal sale will always be paying a "fair" price to the private coal holder also. Of course, this system requires that royalties, rentals, and any other financial consideration be equal before the sale.

c. *Proposed agreement.*—In order to further clarify the proposed pre-sale packaging procedure, the following is the task force's outline of the terms which it believes might be included in a cooperative leasing agreement.

1. The parties agree that it would be mutually advantageous to hold coordinated sales of coal leases covering deposits of Federal and X Company coal.

2. The Department and X Company shall delineate a tract, called the combined tract, which shall not exceed 25,000 acres in size. The combined tract shall be an area of land in which the coal resources can be developed in an efficient, economical, and orderly unit with due regard to conservation of the coal reserves and other resources.

The combined tract shall be delineated from all of the following Federal lands (called the "Federal tract"): [To be described]

The combined tract shall also include all or portions of the following lands owned by X Company (called the X Company tract). [to be described]

All of the lands included in the combined tract shall be contiguous. (An alternative is for the parties to agree to a combined tract constituting a potential logical mining unit prior to entering into the agreement. The agreement would then simply recite a land description of the combined tract.)

3. The X Company shall supply to the Department all available geologic information, including drill logs and isopachous maps, which the Department needs to determine the amount and quality of the coal reserves on the X Company tracts. This information must

then be available to the public without condition. The Department shall also provide like information to X Company, except where the disclosure of such information would violate the Department's confidentiality agreements or the laws respecting the nondisclosure of proprietary information. In such cases, the Department will first request the holder of the proprietary data to release it or, failing that, notify X Company of the existence of such data.

4. The Department will conduct an economic evaluation of that portion of the combined tract which embraces the Federal lands in accordance with the regulations in 43 CFR Subpart 3422. Minimum bonus bids in the Federal tract shall not be less than $25 per acre. Royalties in the lease for the Federal and private tract shall be 12 1/2 percent for a surface mine and 8 percent for an underground mine.

The Department shall, at the same time it evaluates the Federal tract, conduct an economic evaluation of the combined tract and of the X Company tract in accordance with accepted Departmental procedures. The economic evaluation shall be based on the information made available to the Department by X Company as well as other relevant data. The Department and X Company shall use the Department's evaluation of the combined tract and other relevant information to arrive at a mutually acceptable minimum bid and Federal-private bid ratio for the X Company tract. All terms of both sales would be published for comment simultaneously with the request for comment on fair market value of the Federal tract.

5. The Department will hold a lease sale for the Federal tract in October 1981.

The lease sale procedures in 43 CFR Subpart 3422 shall be followed. The Department shall not issue a lease on the Federal tract to any bidder who does not meet the leaseholder qualifications of the Mineral Leasing Act, 30 U.S.C. 181, *et seq.*, or the regulations under 34 CFR Part 3400.

The Department shall issue a lease on the Federal tract to the highest qualified bidder, who has 45 days to conclude a sale agreement with X Company at an amount determined by the bid ratio.

X Company would agree to offer the X Company tract to the highest qualified bidder on the Federal tract. The terms for the sale of the X Company tract (including the bid ratio) shall be published simultaneously with the sale notices of the Federal tract required by 43 CFR 3422.2 together with X Company's agreement to lease to anyone satisfying these terms.

X Company shall not accept any offer that does not conform to the fixed ratio between the bid on the Federal lease and the bid on the private lease which was agreed to by the Department and X Company. The sale notices for the X Company shall specify this ratio.

D. *Post-sale Procedures.*—Once the leases have been issued, the lessee should petition to have the private coal included in the LMU containing the Federal lease at approximately the same time that a mine plan is submitted. The Department is examining two methods of royalty payment distribution for such a consolidated LMU. Under the first alternative, royalties would be received by the Department on an as-mined basis. Distinct and obvious differences in the timing of royalties to the private and public owners could be compensated for in setting the bonus ratio. As a second alternative, the Department is considering whether a proration approach would be feasible. Under such a distribution method, royalties would be paid to the parties in accordance with a sharing formula based on the relative ownership of the coal deposits within the LMU.

E. *Conclusion.*—An approach that potentially allows the systematic cooperative leasing of Federal checkerboard areas has been described. The Department will proceed to implement this procedure barring significant adverse comment and will make changes as appropriate. This approach is based on solving problems as they occur rather than trying to anticipate all possible complexities and resolving them in advance. At the conclusion of the Green River-Hams Fork cooperative leasing sale, the Department will assess the benefits and costs of this method, its general level of workability, and future potential gains or losses to determine a final course of action on cooperative leasing.

[FR Doc. 80-[illegible] Filed 12-29-80; 8:45 am]

BILLING CODE 4310-84-M

Arizona; Public Land, Wilderness Intensive Inventory Final Decision Protest Period Extension Date; Correction

In FR Doc. 80-38282 appearing on page 81264, Column 2, in the issue of Wednesday, December 10, 1980, in the third paragraph, seventh line, change date from December 22, 1980 to December 30, 1980.

Tom Allen,

Associate State Director.

December 17, 1980.

[FR Doc. 80-40446 Filed 12-29-80; 8:45 am]

BILLING CODE 4310-84-M

Office of the Secretary

Oil Shale Environmental Advisory Panel; Meeting

Notice is hereby given in accordance with Pub. L. 92-463 that a meeting of the Oil Shale Environmental Advisory Panel will be held on January 13, 1981, at the Cosmopolitan Hotel, 1780 Broadway, Denver, Colorado. The meeting will begin at 8:30 a.m. on Tuesday, January 13, in the Century Room and conclude by 5:00 p.m.

The Panel was established to assist the Department of the Interior in the performance of its functions in connection with the supervision of oil shale leases issued under the Prototype Oil Shale Leasing Program.

The purpose of this meeting is to review a Draft of the Revised Detailed Development Plan prepared by Rio Blanco Oil Shale Company for Oil Shale Lease Tract C-a in Rio Blanco County, Colorado, to receive progress reports from Interior officials, and to consider any other matters which have come before the Panel. The Panel will also receive a status report on Interior's plans for additional oil shale leasing.

The meeting is open to the public. It is expected that space will permit at least 100 persons to attend the meeting in addition to the panel members. Interested persons may make brief presentations to the Panel on Tuesday afternoon, January 13, or file written statements with the Chairman. Requests to speak to the Panel should be made to Mr. Henry O. Ash, Chariman, Office of the Oil Shale Environmental Advisory Panel, Department of the Interior, Room 690, Building 67, Denver Federal Center, Denver, Colorado 80225, telephone (303) 234-3275.

Further information concerning this meeting may be obtained from Mr. Ash's office. Minutes of the meeting will be available for public inspection 30 days after the meeting at the panel office.

Dated: December 23, 1980.

James W. Curlin,

Acting Assistant Secretary of the Interior.

[FR Doc. 80-[illegible] Filed 12-29-80; 8:45 am]

BILLING CODE 4310-10-M

ATTACHMENT "B"

STATEMENT OF RONALD S. YOUNG
DIRECTOR, BUREAU OF ACCOUNTS
INTERSTATE COMMERCE COMMISSION
BEFORE THE COMMISSION ON FAIR MARKET VALUE POLICY FOR FEDERAL COAL LEASING

September 7, 1983

MEMBERS OF THE COMMISSION:

I am happy to be here today in order to provide you with information regarding the Interstate Commerce Commission's activities in the area of railroad transportation of coal. Although the Commission is not directly involved in the major issues before you, my testimony will focus on various issues dealing with coal transportation in which this Commission has expressed an interest: the ICC's maximum rail rate policy, the potential alternative of coal slurry pipelines, and proposals to allow railroads to lease federal coal lands. Since the Commission has exempted the rail transportation of export coal from regulation,[1] this testimony is limited to movements of coal intended for domestic consumption.

As you know, the Interstate Commerce Commission is presently involved in implementing the Staggers Rail Act of 1980, legislation which profoundly changed the regulatory system for the railroad industry. The Staggers Act represented the second major effort in five years to resolve the continuing problem of railroad revenue adequacy.[2] This legislation has substantially reduced Federal regulation of the rail industry, while providing rail carriers with the opportunity to obtain adequate earnings. The Act was intended to assist the rail system to remain viable in the private sector of the economy and to allow the railroads to compete more effectively among themselves and with other modes of transportation.[3] To assist in the revitalization and modernization of the rail system, the Staggers Act encourages competition, provides for the prompt recovery of costs, promotes greater rate and service flexibility without government interference, and emphasizes the need for adequate rail revenues. While there is greater reliance on the forces of the marketplace, a regulatory process remains to balance the needs of carriers, shippers, and the public where warranted, such as in the absence of effective competition.

---

[1] Ex Parte No. 346 (Sub-No. 7), Railroad Exemption - Export Coal.

[2] The first was the Railroad Revitalization and Regulatory Reform Act of 1976 (the 4R Act).

The Staggers Act provides the railroads with substantially more rate freedom than was afforded prior to its enactment. Generally, in the absence of market dominance, a rail carrier may establish a rate at any level it desires (absent discrimination) so long as it contributes to going concern value. The Act also establishes a revenue-variable cost threshold below which the Commission has no jurisdiction over the reasonableness of rates. If the carrier has market dominance and the rate exceeds the jurisdictional threshold, the Commission, on complaint or protest, is authorized to determine whether the rate is reasonable. In determining whether a rate is reasonable, the Commission is required to recognize the policy that rail carriers are to earn adequate revenues.

---

[3] The goals of the Act, as set forth in section 3, are as follows: (1) to assist the railroads of the Nation in rehabilitating the rail system in order to meet the demands of interstate commerce and the national defense; (2) to reform Federal regulatory policy so as to preserve a safe, adequate, economical, efficient, and financially stable rail system; (3) to assist the rail system to remain viable in the private sector of the economy; (4) to provide a regulatory process that balances the needs of carriers, shippers, and the public; and (5) to assist in the rehabilitation and financing of the rail system.

In a decision served February 24, 1983, the Commission proposed a maximum rail rate policy applicable to captive coal traffic.[4] Under the proposed "constrained market pricing" approach, rail carriers' pricing of market dominant coal traffic would be subject to four upward constraints. First, a coal shipper could not be charged more than the "stand-alone cost" of serving its traffic. Second, captive shippers would not be required to bear the cost of pricing inefficiencies. This constraint also incorporates the statutory standard of "honest, economical and efficient management." Third, carriers would generally not be permitted to increase their rates on captive traffic by more than 15 percent in a single year (after inflation). Fourth, until a rail carrier achieves revenue adequacy, it would be free to adjust its rates on captive coal traffic unless it violates one of the three other constraints.

This proposal represents the culmination of the Commission's efforts to arrive at a formula for prescribing maximum reasonable coal rates. To achieve the revenue adequacy goals of the Staggers Act, railroads should be able to assess rates high enough to recover on a system-wide basis all variable costs and constant costs, including a return on investment equal to the current cost of capital. The difficulty lies in the fact that not all rail movements can be priced at this level, mainly due to varying forms of competition. This contrasts, for example, with electric utility ratemaking, a situation in which the users generally have virtually no other option. Accordingly, to reach revenue adequacy, railroads have to price differentially some movements (in other words, allocate constant costs disproportionately).

---

[4] Ex Parte No. 347 (Sub-No. 1), Coal Rate Guidelines.

The Commission has considered various constant cost allocation methodologies in this proceeding--ratio method, revenue additives, ton/ton-mile. Ultimately, each of these methods has been found to be somewhat arbitrary, and not based on a sound economic or regulatory basis. Accordingly, they have been rejected.

In this decision, the Commission proposed a modification of the theoretical framework of Ramsey pricing to allocate constant costs. Basically, the Ramsey pricing framework assigns a mark-up above marginal cost on the basis of inverse demand elasticity. Theoretically, this would yield the most economically efficient rates and the proper allocation of constant costs.

Our modifications of the Ramsey pricing model were adopted for practical reasons. Ramsey pricing is based on a mathematical formula which requires precise calculation of the elasticity of demand and marginal cost for every movement. The Commission concluded that, since we do not have such data and it would be difficult and extremely burdensome to develop, pure application of the Ramsey pricing model would be inappropriate. However, the

Commission believes that the "market forces" theory behind Ramsey pricing is relevant and can be relied upon in conjunction with the regulatory constraints outlined above.

Let me turn now to the issue of coal slurry pipelines. The Commission has testified or submitted comments on this subject a number of times over the past several years. In general, the Commission favors the construction of coal slurry pipelines to enhance competition. However, it is, and has been, the Commission's view that delegation of the Federal power of eminent domain involves important policy questions which the Congress should decide. The question of coal slurry pipelines involves a complex set of issues - including land management, environmental concerns, water rights, and transportation. In deciding whether the Federal government should provide certain economic interests with the substantial right of eminent domain, Congress must address and balance all of these concerns.

It is, of course, the transportation issues relating to coal pipeline development that are of concern to the Commission. Should Congress decide to grant the right of eminent domain to coal pipeline operators in a process which involves findings on transportation issues, it is the Commission's view that it would be appropriate to give the Commission implementing authority. For example, the required findings in S. 267, the "Coal Distribution and Utilization Act of 1983", include several matters relating to coal transportation issues, matters particularly within the Commission's expertise. The bill requires findings concerning the pipeline's likely effects upon competition, the extent to which the pipeline would reduce coal transportation costs, and consideration of alternate routes or means of distributing coal. Also, various aspects of coal pipeline operations, such as rates, already are subject to Commission regulation.

I repeat that the Commission has taken no position on whether the right of Federal eminent domain should be granted to coal slurry pipeline operators. With regard to the transportation issues involved, if the Congress believes Federal eminent domain should be provided, the Commission believes the ICC is the appropriate agency to be given authority under the legislation.

Finally, I would like to respond to your request for comments on the proposed repeal of sec. 2(c) of the Mineral Leasing Act of 1920. Sec. 2(c) of the Mineral Leasing Act of 1920 prohibits a common carrier railroad from holding federal coal leases. Several of the western land grant railroads currently own significant land holdings which contain coal deposits. These railroad-owned lands form a checkerboard pattern with federal lands in the West, which overlays many of the large western coal deposits. It has been proposed that the prohibition against the purchase of federal coal leases by railroads be removed, thereby facilitating the mining of these coal reserves.

A variety of issues must be addressed in reaching a decision on the merits of this proposal. Among these issues are the effect of railroad participation in the coal industry on competition in that industry, and the environmental effects of increased surface mining activity in the West. These are matters which should be considered and weighed by Congress. Transportation issues have also been raised in connection with this proposal, and it is these concerns which I would like to address at this time.

One of the concerns raised has been the ability of the railroads to use their market power in the transportation of coal in an effort to drive up the delivered cost of coal or to discriminate against other coal shippers in favor of their own coal transportation needs. Some have expressed concern that a railroad could charge a mining subsidiary or sister corporation lower rates for transporting coal than the railroad charged other coal shippers, thereby obtaining a competitive edge over other coal producers. Others fear that a railroad could refuse to serve its competitor's mining facilities by declining to make cars available for other coal shippers.

The Commission expressed its views on the repeal of sec. 2(c) in a letter to the Subcommittee on Energy and Mineral Resources of the Senate Committee on Energy and Natural Resources on September 30, 1981. As stated in that letter, the Commission believes that its regulation of the railroad industry, together with Justice Department review, is adequate to prevent these types of abuses of market power. Under Section 15 of the Federal Coal Leasing Amendments Act of 1976, the Justice Department must review proposed federal coal leases to determine whether a proposed lease would create a situation inconsistent with the antitrust laws. An examination of the potential for these kinds of abuses would certainly be part of such review.

As indicated earlier, passage of the Staggers Rail Act of 1980 has increased rail carriers' ability to set rates without ICC interference in many areas. Nevertheless, the Commission retains significant authority in the area of maximum rates. For example, rates on captive traffic above a specified jurisdictional threshold must still meet a reasonableness test. If a carrier has market dominance, the Commission can suspend or investigate a rate on the ground that it is unreasonably high if the revenue-variable cost ratio of the movement exceeds 170 percent.[5] The maximum rate guidelines contained in Ex Parte No. 347 (Sub-No. 1), Coal Rate Guidelines, which were described earlier in my statement, reflect the Commission's current thinking regarding the standards to be applied in determining the reasonableness of a rate. The Commission believes that its authority to review rates to determine their reasonableness is adequate to prevent the abuse of market power.

Among the reforms contained in the Staggers Act are substantial changes to the rate discrimination provisions of Subtitle IV of title 49, United States Code. As amended by the Staggers Act, differences between rates of rail carriers do not constitute rate discrimination if such differences result from different services provided by the carriers. For example, the prohibition against discrimination does not apply to separate rates for distinct rail services. In addition, contract rates generally cannot be challenged on the ground of rate discrimination. The provisions of the Staggers Act increased the incentives for carriers and shippers to negotiate long-term contracts, particularly for the transportation of bulk commodities such as coal. Contracts must be submitted to the Commission for approval, and shippers can protest the terms of contracts on specified grounds. The Commission may disapprove a contract if it determines that the contract will prevent the carrier from fulfilling its common carrier obligation to serve a complaining shipper. Except in the case of agricultural commodities or challenges by ports, the Commission may not disapprove a contract because the rate unreasonably discriminates against some other shipper. Therefore, it is possible that a rail carrier could negotiate a contract rate with its mining subsidiary which was significantly lower than the rates charged to other coal shippers. On the other hand, the railroads have substantial incentives to negotiate equitable contract rates with all of their coal customers.

---

[5] On October 1, 1983, this jurisdictional threshold will increase to a revenue variable cost ratio of 175 percent. Statutory exceptions to the Commission's suspension and investigation power for inflation-based rate increases and zone of rate flexibility are not relevant here.

In response to concerns regarding car service, the common carrier obligation continues under the Staggers Act, and Commission enforcement of this obligation to serve is adequate to prevent abuses in this area. As mentioned above, the Commission may reject a contract if its terms jeopardize the railroad's ability to provide service to other shippers on reasonable request. In addition, the Commission monitors the rail carriers' allocation of cars to detect and halt abuses in this area.

In summary, the Commission has expressed its belief that, should Congress repeal sec. 2(c), the Commission's regulations under Subtitle IV of title 49, United States Code, along with enforcement of the antitrust laws, are adequate to ensure that railroads do not abuse their market power in the transportation of coal in order to manipulate the market for coal.

Again, I am glad to provide you with information in this area, and I would be happy to answer any questions you may have.

ATTACHMENT "C"

RE: Application of the Antitrust Laws to the Railroad Industry

Attached is a copy of testimony given before the Senate Judiciary Committee on September 24, 1985, by James A. Calderwood, Esquire, a Washington attorney who was formerly with the Antitrust Division of the Department of Justice. This testimony makes the point that under present law the railroads enjoy broad exemptions from application of the antitrust laws. Therefore, the antitrust laws would not be an effective check on the obvious potential for abuse by a railroad if it is permitted to acquire federal coal properties and to compete against independent coal companies who are dependent on the railroad for transportation of their coal. This is the most common situation today in the areas where the railroads seek to acquire federal coal reserves.

The broad exemption of railroads from application of the antitrust laws must be narrowed, or other protections enacted, if Section 2(c) of the Mineral Leasing Act is amended to permit railroads or their minerals affiliates to acquire and operate federal coal reserves. At the time most of the statutory exemptions were enacted or the cases granting exemptions were decided, the railroads were subject to extensive regulation by the ICC. Also, Section 2(c) was designed to prevent railroads from being in the dual position of a seller of coal and a tranporter of its own and its competitors' coal, because of the obvious conflicts of interest and opportunities for unfair competition involved. The Staggers Act, as interpreted and implemented by the ICC, has seriously eroded the regulatory power and supervision of the ICC over rail freight rates. Amendment or repeal of Section 2(c), without accompaning legislative protections against the possibility of abuse of the railroads' monopoly power over transportation, would effectively put the railroads in the position of being able to use this monopoly power with essentially no private recourse for an injured competitor under the antitrust laws.

The applicability of the present antitrust laws to railroads can be briefly summarized as follows:

Sherman Act

- Section 1: Prohibits agreements in restraint of trade. Under this section, as interpreted by the U.S. Supreme Court, an agreement between a railroad and its wholly owned minerals subsidiary would not be sufficient to invoke Section 1 of this Act, since a parent corporation and its wholly owned subsidiary are legally incapable of conspiring with each other under Section 1 of the Sherman Act.
- Section 2: Prohibits monopolies or an attempt to monopolize. Under the Keogh doctrine, a railroad would be immune from a damage award under both Sections 1 & 2 of the Sherman Act on the theory that this would frustrate the rate making jurisdiction of the ICC.* This bars private antitrust damage suits.

Clayton Act

- Section 7: Prohibits anti-competitive mergers. This Section would not apply except in a merger situation. In addition, it exempts from its application mergers subject to ICC jurisdiction, which presently includes railroad mergers.
- Section 16: Permits private suits for injunctive relief under the antitrust laws, except a suit against a common carrier (e.g. a railroad).

---

* Whether this doctrine remains viable after enactment of the Staggers Act is an open question; the Supreme Court has agreed to hear a case involving a related issue but this issue has not yet been finally decided.

Robinson-Patman Act

- Prohibits price discrimination, but applies only to the sale of commodities, and is therefore inapplicable to transportation services.

Federal Trade Commission Act

- Prohibits "unfair methods of competition" and "unfair or deceptive acts or practices" effecting commerce, and directs the FTC to prevent any person or corporation from using such unfair methods of competition or unfair practices, except (among others) common carriers (e.g. railroads).

Clearly, any consideration by Congress of an amendment to Section 2(c) which would permit railroads (or their minerals subsidiaries) to compete against other coal companies over which they have monopoly transportation power, must also include a re-examination and reconsideration of these antitrust exemptions for railroads, particularly in light of the post-Staggers de facto deregulation of railroad transportation rates. Effective protection against the potential misuse of this monopoly power must be incorporated into any such legislation, or must be accompanied by protective changes in the Staggers Act or the antitrust laws.

LAW OFFICES
GROVE, JASKIEWICZ, GILLIAM AND COBERT
SUITE 501
1730 M STREET, NORTHWEST
WASHINGTON, D.C. 20036

TELEPHONE
[illegible]
TELECOPIER
[illegible]
TELEX [illegible]
CABLE "AMERICALAW"

MANUFACTURERS BANK BUILDING
SUITE 1008
16255 VENTURA BOULEVARD
ENCINO, CALIFORNIA 91436
(213) 872-2202

APPLICATION OF THE ANTITRUST LAWS TO THE RAILROAD INDUSTRY

Prepared testimony of James A. Calderwood, Esquire,* before the Committee on the Judiciary, United States Senate, hearings on S. 447, the "Railroad Antimonopoly Act of 1985," September 24, 1985.

INTRODUCTION

Historically the antitrust laws have rarely been of major importance in the legal atmosphere in which railroads operate. The nation's first national regulatory agency, the Interstate Commerce

---

* Mr. Calderwood was for many years a senior trial attorney with the Antitrust Division of the Department of Justice. For most of this time he was with what is now the Transportation Section of the Antitrust Division. He is presently the partner in charge of the Antitrust Group of the Washington, D.C. law firm of Grove, Jaskiewicz, Gilliam and Cobert. He has litigated several antitrust cases involving transportation companies and rendered advice to carriers and shippers concerning the antitrust laws and transportation. He has written many articles dealing with antitrust/transportation problems and chairs the Editorial Board of the monthly publication Transportation Antitrust Report. He is an honors graduate of the law school at George Washington University, which he attended on scholarship, and has studied the problems of competition regulation at Oxford University.

Commission (ICC) was established in 1887 to control the rail industry. 1/ This was three years before the first antitrust statute, the Sherman Act, was enacted. Hence, from their very beginning, the antitrust laws were not looked upon as the key method of controlling economic abuse by railroads. As Congress recognized various types of railroad problems and as shippers or communities felt a need to have the railroad industry restrained in certain ways additional legislation was passed giving the ICC increasing authority over almost all aspects of rail carrier operations. This included the Hepburn Act in 1906 2/ the Mann-Elkins Act in 1910 3/, and the Transportation Act of 1920. 4/

Interestingly, some of the earliest Supreme Court cases under the Sherman Act involved rail practices (*e.g.* *United States* v. *Trans-Missouri Freight Assn.*, 166 U.S. 290 (1897) and *United States* v. *Terminal Railroad Assn.*, 224 U.S. 383 (1912)). While these cases found that the Sherman Act applied to railroads (to prohibit price fixing in the first case and to prohibit an agreement among railroads to control access to bridges crossing the Mississippi river in the latter case) it was decided by Congress, early in this century, not to rely upon the antitrust laws to prevent railroad abuse, but instead to enact legislation giving the ICC the authority to regulate most railroad activity.

It developed that if a shipper, equipment supplier, connecting railroad, particular community or anyone else with a real or imagined problem with a railroad wanted to seek legal means to deal with the problem it would approach the ICC and ask that agency to control the situation. The ICC's power over the railroads was pervasive and often utilized. Consequently, there was not, until recently, a significantly felt need to rely upon the antitrust laws to deal with rail carrier abuse.

ANTITRUST OVERVIEW

It is important in analyzing the current state of the antitrust laws as they apply to the railroad industry to understand just what types of practices the antitrust laws apply to with respect to most of American industry and then to see if these antitrust laws apply to these same practices by railroads.

In a nutshell the most important provisions of the antitrust laws are: The Sherman Act which makes unlawful two types of practices: 1. agreements in restraint of trade (*e.g.* price fixing, group boycotts) 5/ and 2. abuses of a market position (monopolization or attempts to monopolize) 6/; Section 7 of the Clayton Act, prohibiting mergers which may substantially lessen competition or tend to create a monopoly 7/; The Robinson-Patman Act (which is an amendment to the Clayton Act) prohibiting price discrimination 8/ and Section 5 of the Federal Trade Commission Act prohibiting unfair or deceptive acts or practices. 9/ Not only can the Government bring actions against most commercial entities to enforce these provisions, but, with respect to the vast majority of American industry, private parties may also institute damage suits 10/ and injunction actions 11/ (except for the Federal Trade Commission Act under which private suits, either for damages or for injunctions, are not permitted).

THE SHERMAN ACT

As noted, the Supreme Court held in the early days of the Sherman Act that that Act prohibited price fixing by railroads (United States v. Trans-Missouri Freight Assn., supra), and abuses of monopoly power by railroads (United States v. Terminal Assn., supra). However, because of the existence of the ICC and its comprehensive power over railroads, few such cases were brought. It was simply faster and more efficient for shippers and others to proceed at the ICC than to initiate Sherman Act litigation.

Finally, for all practical purposes, private suits against railroads for price fixing or monopolization stopped in 1922 when the Supreme Court held in Keogh v. Chicago & Northwestern Railway, 260 U.S. 156, that railroads were immune from damage awards under the Sherman Act reasoning that to award antitrust damages would frustrate the rate regulation jurisdiction of the ICC. The Court stated in Keogh that if rates, even collusively set ones, were approved by the ICC then no damage action was permitted.

The Keogh decision stands today as a barrier to private Sherman Act litigation against railroads. Recent court decisions have reaffirmed Keogh so that it continues as a major obstacle to instituting antitrust cases against railroads. See Minsky v. Auto Driveaway, 757 F.2d 718 (7th Cir. 1984), cert. denied 105 S. Ct. 435 (Nov. 7, 1984); In the Matter of Wheat Rail Freight Rate Antitrust Litigation, 759 F.2d 1305 (7th Cir., 1985), cert. petition pending No. 85-21; Square D Co. v. Niagara Frontier Tariff Bureau, Inc. 760 F.2d 1347 (2nd Cir. 1985), cert. petition pending No. 85-112; In Re Lower Lake Erie Iron Ore Antitrust Litigation, MDL 587 (E.D. Pa., June 7, 1985). With the Supreme Court's declination just ten months ago to review the Minsky decision there are real doubts that the Supreme Court will now change the doctrine on its own.

Hence, unlike most of the American commercial world, the railroad industry does not have to be concerned with private suits for price fixing, monopolization or attempts to monopolize. In addition, by statute, injunction actions by private parties against railroads under any of the antitrust laws are not permitted because Section 16 of the Clayton Act 12/ expressly prohibits such actions against ICC regulated carriers accept by the Department of Justice.

When Congress enacted the 4-R Act 13/ and the Staggers Act 14/ it severely restricted the activity of railroad rate bureaus and greatly narrowed the legislative antitrust immunity enjoyed by such bureaus for price fixing. 15/ There is a popular misconception that Congress thereby made the railroad industry subject to the panoply of the antitrust laws. This was definitely not the situation.

While the 4-R Act and the Staggers Act removed much of the statutory antitrust exemption permitted railroad rate bureaus so they could engage in price fixing, it did not by any means restore full antitrust liability to the rail industry. Because of the *Keogh* decision and its recent progeny and Section 16 of the Clayton Act the rail industry remains basically immune from antitrust attack from anyone but the Department of Justice.

One may then ask how active has the Department of Justice been in instituting antitrust cases against railroads since the Staggers Act was passed in 1980? The answer is not very active at all. Since enactment of the Staggers Act, the Department of Justice has brought exactly one antitrust case against rail carriers. 16/ In that case, four of the five defendant railroads plead no contest, which was accepted by the court, and the fifth defendant won at trial with a directed verdict of not guilty.

OTHER ANTITRUST STATUTES

In the beginning of my remarks I mentioned the other most important sections of the antitrust laws in addition to the Sherman Act. Like the Sherman Act, they are also inapplicable to the railroad industry. Section 7 of the Clayton Act, the statute which prohibits anticompetitive mergers, exempts from its coverage by its very language mergers subject to ICC jurisdiction and railroad mergers are presently subject to ICC jurisdiction. 17/ The anti-price discrimination statute, the Robinson-Patman Act, applies only to the sale of commodities and therefore is inapplicable to transportation services. The Federal Trade Commission (FTC) has no jurisdiction over railroads because Section 5(a)(2) of the Federal Trade Commission Act 18/ exempts ICC regulated entities from FTC jurisdiction.

Consequently, the railroad industry in America today is free from practically all of the provisions of the antitrust laws which apply to most other phases of American business.

MARKET DOMINANCE

I will not here review all the issues involved with market dominance findings by the ICC under the Staggers Act. However, let me briefly outline the problem. Prior to the 4-R Act and the

Staggers Act all rail rates were tightly regulated by the ICC. Now under 49 U.S.C. § 10709 the ICC may not find a rate unreasonable unless it first makes a finding of market dominance in accordance with standards stated in that section. Since passage of the Staggers Act in 1980 the ICC has rarely found a market dominance situation and, even when it has, the ICC has always found the rate being charged by the railroad in question to be reasonable. In effect, despite the clear intent of Congress to protect shippers under the market dominance standard from railroad rate exploitation in rail monopoly situations the ICC has failed to take any real action. If anything, the ICC's reaction to the Congressionally imposed market dominance standard has been one of tortured starting and stopping in various proceedings developing evidentiary guidelines which leave it almost impossible for shippers, faced with rail monopolies, to be protected from the imposition of monopoly rates. 19/

THE RAILROAD ANTIMONOPOLY ACT

The railroad industry is in the most advantageous position possible for major American corporations. Because of legislative enactments and judicial interpretations they are free from most of the antitrust laws and the regulatory agency with possible authority over them has so interpreted its own authority as to render it impotent to maintain any control. This legal atmosphere is coupled with an ever more concentrated railroad industry. Railroad consolidations continue with the pending mergers of the Santa Fe and the Southern Pacific, the possible acquisition of Conrail by the Norfolk Southern. This would leave probably six major rail systems operating in the United States.

The simple economic fact is that these railroad consolidations have left many communities with no competitive rail service. Some states are, for all practical purposes, served by only one rail system.

Shippers and communities faced with this railroad market situation have been stymied in their efforts to prevent rail monopoly abuses. They are effectively banned by the *Keogh* decision from actions under Section 2 of the Sherman Act (the anti-monopolization section), prohibited from bringing injunction actions by Section 16 of the Clayton Act, frustrated at the ICC because of that agency's failure to take any action in the last 5 years to effectively deal with market dominance, coupled with the fact that the Department of Justice has instituted only one anti-trust case against a railroad since passage of the Staggers Act and that case did not charge a Section 2 violation.

The Railroad Antimonopoly Act is hardly a radical proposal. Actually, it is a rather narrow piece of legislation which would only make railroads subject to the Sherman Act in a limited manner.

If enacted, the railroad industry would continue its privileged position in American industry of being largely immune from the antitrust laws and from effective regulation.

Basically, the bill would legislatively overturn the Keogh decision with respect to Section 2 of the Sherman Act and would also allow injunctive relief to private antitrust litigants when rail monopoly abuse is found. In effect, the bill does this through Congressional recognition of the "essential facilities" doctrine with respect to railroads.

The "essential facilities" doctrine (also sometimes referred to as the "bottleneck monopoly" doctrine) is a long recognized antitrust doctrine which goes back to the 1912 Terminal Railroad Assn. decision, referenced earlier. In that case, the Supreme Court held that it violated the Sherman Act for a group of railroads to jointly control the facilities for rail transportation across the Mississippi river and effectively bar others from using the "essential" facility.

Probably the most succinct case finding a Sherman Act violation due to the denial of access to an essential facility is Otter Tail Power Co. v. United States, 410 U.S. 366 (1973). There the Supreme Court held it was unlawful for an electric utility system operating the only electric transmission system in the region to refuse to transmit power over its lines; such power being cheaper than the price asked by the defendant utility system. Of course, it was recognized that the utility system was entitled to some compensation for the use of its facilities, but the defendant system could not abuse its monopoly position by denying access to its essential facility for transmitting electric power to others.20/

The Railroad Antimonopoly Act would remove the Keogh impediment to bringing essential facility type cases under the Sherman Act when it is established that a particular railroad is the sole rail facility available to a shipper and the railroad is effectively seeking to monopolize or has monopolized rail transportation to a particular destination. If the railroad has established reasonable terms for the use of its monopoly facility it would not violate the Sherman Act. Private litigants would have available both antitrust damage and injunction remedies.

This bill would do no more than make rail carriers subject to essential facility antitrust actions the same as the rest of American industry. It does not create some new theory of antitrust relief and does not make railroads subject to the full range of the antitrust statutes.

CONCLUSION

If the railroad industry wants to function in a deregulated, market oriented fashion then, like other major industries, railroads should be subject to at least a portion of the antitrust laws and shippers given an opportunity to curb railroad monopoly abuses, something shippers cannot now expect the Government to do.

James A. Calderwood

FOOTNOTES

1. Interstate Commerce Act, 24 Stat. 37 (1887).

2. Hepburn Act, 34 Stat. 584 (1906).

3. Mann-Elkins Act, 36 Stat. 539 (1910).

4. Transportation Act of 1920, 41 Stat. 456 (1920).

5. 15 U.S.C. § 1.

6. 15 U.S.C. § 2.

7. 15 U.S.C. § 18,

8. 15 U.S.C. § 13(a)-(f).

9. 15 U.S.C. § 45.

10. 15 U.S.C. § 15.

11. 15 U.S.C. § 26.

12. *id*.

13. Railroad Revitalization and Regulatory Reform Act, 90 Stat. 91 (1976).

14. Staggers Rail Act of 1980, 94 Stat. 1895 (1980).

15. Legislatively sanctioned in 1948 with passage of the Reed-Bulwinkle Act, 62 Stat. 472 (1948), now codified as revised at 49 U.S.C. 10706(a). The Reed-Bulwinkle Act was enacted in response to the Supreme Court's decision in *Georgia* v. *Pennsylvania Railroad Co.*, 324. U.S. 439 (1944).

16. *United States* v. *Baltimore and Ohio Railroad*, Criminal No. 81-396 (D.D.C. filed Oct. 13, 1981).

17. 49 U.S.C. 11343.

18. 15 U.S.C. 45(a)(2).

19. *See* generally *Western Coal Traffic League* v. *United States and the ICC*, 674 F.2d 378 (1982), *modified* 719 F.2d 772 (5th Cir.

1983), *cert. denied*, 104 S. Ct. 2160 (1984) and 719 F.2d 772 (5th Cr., 1983), *cert. denied*, 104 S. Ct. 2160 (1984).

20. For other cases concerning the essential facilities doctrine *see* *Associated Press* v. *United States*, 326, U.S. 1 (1945), *Silver v. New York Stock Exchange*, 373 U.S. 341 (1963), and *City of Chanute* v. *Kansas Gas and Electric Co*., 754 F.2d 310 (10th Cir. 1985).

Aspen Skiing Co. v. Aspen Highlands Skiing Corp.,
53 U.S.L.W. 4815

SF Minerals Corporation

6200 Uptown Blvd. N.E. Suite 400
Box 27019
Albuquerque, New Mexico 87125
505/881-3050

January 21, 1986

Hon. John W. Warner, Chairman
Subcommittee on Natural Resources
Development and Production
Committee on Energy and Natural Resources
Room SD-306
Dirksen Senate Office Building
Washington, D.C. 20510

Re: Hearing Record on Federal Coal Leasing Legislation

Dear Senator Warner:

This will respond to the questions propounded to me in your letter of November 19, 1985, following my testimony before the subcommittee on November 8, 1985.

A. Questions for Railroad Affiliates

1. What is your response to Mr. Holsten's testimony that railroads would use their alleged transportation monopoly to discriminate in favor of their coal affiliates with respect to rates and conditions of service?

I reject the repeated assertions by our competitors that our affiliate, Santa Fe Railway, would discriminate or give preferential treatment to its affiliated coal companies or their customers with respect to rates or other conditions of service in the transportation of coal produced from federal leases. There is no historical basis for such concern. Indeed, SF Coal Corporation is currently marketing coal to Tucson Electric Power Company that is transported over the Santa Fe Railway. Tucson negotiated that transportation arrangement with Santa Fe Railway and there is no claim of which I am aware that Tucson received any special treatment. Elsewhere in the Southwest, our subsidiary SF Coal has bid for business to companies like Southwest Public Service in Amarillo, Texas, and the Salt River Project in Phoenix, Arizona in competition with other producers who ship on the Santa Fe Railway and has lost that business to those other suppliers because they reportedly provided a lower delivered cost of coal. Also, if Mr. Holsten's concern had any validity, then it should apply with equal weight to situations where SF Minerals has leased its coal to others for development, as at Mr. Holsten's McKinley Mine in New Mexico, inasmuch as a theoretical opportunity exists to maximize lease revenues from that deposit by granting perferential treatment to Mr. Holsten's shipments. No such preferences exist, which further belies Mr. Holsten's

A Santa Fe Southern Pacific Company

hypothetical scenario. There are at least two very good reasons why Santa Fe Railway has never discriminated in favor of coal produced by its affiliates or their lessees: (1) Santa Fe Railway lacks the monopoly power and economic incentive to engage in such practices as the Justice Department has consistently recognized; and (2) it would violate the anti-discrimination provisions of the Interstate Commerce Act and might provide the basis for charges that the antitrust laws were being violated. The basic premise of Mr. Holsten's argument was rejected by the Department of Justice in its 1980 report to Congress on Competition in the Coal Industry. Furthermore, those conclusions were reaffirmed by the Justice Department after the enactment of the Staggers Act in the 1983 testimony of Assistant Attorney General William F. Baxter before the Linowes Commission, a copy of which is submitted herewith for inclusion in the hearing record.

Our competitors nevertheless contended at the November 8 hearing that the enactment of the Staggers Act has substantially weakened the anti-discrimination provisions of the Interstate Commerce Act. Whether that is true or not, it is clear that the kind of possible discriminatory, anticompetitive behavior our competitors seem concerned about would continue to be proscribed by the antitrust laws. However, in order to avoid further bickering over what the state of the law may be on this subject and to lay this ghost to rest once and for all, I would have no objection to an amendment to Senator McClure's amendment No. 801, the so-called compromise amendment, which would either (1) ban undue discrimination in rates or conditions of service for transportation of coal from federal leases held by an affiliated company along the lines of the condition contained in the section 2(c) amendment which was defeated in the House Interior Committee in 1975 or (2) extend the Interstate Commerce Act's ban on discrimination in the shipment of agricultural commodities to shipments of coal from federal leases held by affiliated companies, as I indicate in my answer to question 10 herein. Coupled with the other provisions of the compromise amendment, an aggrieved producer would have a clear cut cause of action for violation of a new, unequivocal anti-discrimination provision.

Furthermore, my lawyers advise me that if such discrimination were part of a conspiracy in restraint of trade between Santa Fe Railway and an affiliated coal company holding a federal coal lease, not only would the sanctions of the antitrust laws be available to injured coal producers, but section 27 of the Mineral Leasing Act (30 U.S.C. § 184(k)) appears to subject any coal leases involved in such conspiracy or combination to cancellation.

Thus it seems clear to me and our lawyers that existing law, supplemented with the disclosure provisions of Senator McClure's compromise amendment and my proposed anti-discrimination provision, would be a formidable deterrence to the kind of discriminatory hanky-panky which our competitors allegedly fear, baseless as those fears may be.

2. What is your response to Mr. Holsten's testimony (page 8) that "even assuming comparable rates are quoted by the railroad, what assurance is there that there would not be an unfair allocation between the quoted freight rate and the affiliate's mine price so that most of the railroad's total profit for the two functions, mining and transportation, would be allocated to the freight rate"?

Mr. Holsten's new math, by which he concludes that my companies can somehow prosper by selling our coal at little or no profit so that the railroad can haul it, is so farfetched that it probably deserves no answer. I can assure the committee that the welfare of my companies, my continued employment by those companies, and the welfare of all of the employees of our coal operations depends on profitability of our coal mining operation, not on the profitability of Santa Fe Railway's coal hauling operations. I can assure you that we have no intention of giving away our coal in order to permit some increases in the railroad's coal traffic.

Mr. Holsten's theory again was carefully scrutinized and rejected by the Justice Department in 1980 and 1983, as pointed out above. While his scenario may be a theoretical possibility, it has no basis in economic reality. A more likely possibility along the lines of Mr. Holsten's scenario, and one about which Congress was very much concerned in enacting sections 3 and 7 of the Federal Coal Leasing Amendments Act of 1976, is that a major energy company, such as Mr. Holsten's parent company, would be able to allocate development efforts and profits among the four major energy sources it controls - oil, gas, coal and uranium. Thus, Chevron could afford to cut its profits on coal in order to compete in that market because it could compensate for those low margins with possible higher prices in the oil or gas markets. Does this mean that Chevron and all its affiliates should be denied federal coal, oil or gas leases? Mr. Holsten's theory seems to suggest such a result. More specifically with respect to oil, Chevron produces, refines, transports and markets that energy fuel and may allocate profits among those four functions as it chooses. Does Mr. Holsten suggest that Chevron should be barred from any of those economic activities because of the potential for an "unfair" allocation of profits among those functions? I think not. In short, his argument with respect to 2(c) is a specious smokescreen for his real motive - to prevent my coal company from becoming a more effective competitor in the western coal market - and should be rejected.

3. With respect to your discussions with your industry opponents to modification of 2(c), Mr. Holsten testified (page 9) that "the industry group that met this summer did discuss our transportation concerns but the remedies offered to avoid the potential of discriminatory ratemaking were all after the fact, after the business had been awarded, and hence of little value to a commercial producer who had already lost the business to a railroad's mining affiliate." Please comment on that analysis.

The efforts we have made in our compromise proposal are efforts to overcome the alleged concerns of our competitors, although we do not believe those concerns to be valid or possible under the existing laws. In essence they are asking for assurances that we not violate the law. The disclosure procedures we have proposed would give them the basis for determining whether or not the law has been violated. If it has, they could of course seek redress, including cancellation of contracts or whatever other remedies they might persuade a court would be appropriate. That still has not satisfied them, so I have made the further proposal outlined in my answer to Question No. 1 above. I do not see what else we can propose in the context of the coal leasing legislation to establish a stronger deterrent to possible discriminatory action by our sister railroad. We certainly cannot agree to any legislative approach that would require us to disclose our bids to our competitors prior to the award of the business being made.

4. Please comment on Mr. Holsten's testimony (page 12) that "under the Interstate Commerce Act rate discrimination against a coal shipper is not illegal when the traffic is covered by a transportation contract."

Please refer to my answer to Question No. 1 above.

5. What is your response to Mr. Holsten's suggestion (page 14) that, if section 2(c) is repealed, the present exemption of railroads from the prohibitions of unfair trade practices under the Federal Trade Commission Act would have to be re-examined?

I have no knowledge of why Congress chose to exempt railroads from the prohibition against unfair trade practices under the Federal Trade Commission Act, but I assume that it felt that such practices were adequately proscribed by then existing law. If that is no longer the case, I personally would not object to Congress revisiting the subject, but not in the context of this coal leasing legislation, since the exemption is industrywide and covers a variety of other commodities. In any event, I want to stress that my coal companies are certainly not exempt from the prohibition on unfair trade practices. Consequently I assume that if we engaged in any joint activities with our sister railroad of the kind prohibited by the Federal Trade Commission Act we would be subject to the Act's sanctions.

6. What is the significance of the fact, pointed out by Mr. Holsten in his testimony (page 16), that only 2 of the 5 members of the Linowes Commission recommended repeal of section 2(c)?

My understanding is that the members of the Linowes Commission who voted for repeal of Section 2(c) of the Mineral Leasing Act of 1920 were the same two members that voted for repeal of Section 3 of the Federal Coal Leasing Amendments Act and that they represented the majority of those voting on those two subjects. Repeal of 2(c) has also been advocated by the Justice Department, the Interior Department and others under five past administrations and, in that context, I find the action of the Linowes Commission and the inclusion of that recommendation in their final report to be significant.

7. What is your response to Mr. Holsten's suggested "resolution of the section 2(c) problem" at page 17 of his testimony and his recommendation that any action on 2(c) "should proceed separately from the consideration of needed amendments to Sections 3 and 7" (page 18)?

Mr. Holsten's suggested resolution of the 2(c) problem is that the restriction be removed only for areas outside of the exclusive service area of our affiliated railway. Leaving to one side how "exclusive service area" would be defined, in my view this would unfairly preclude our companies from competing within a large area of the western United States and would only perpetuate what has already been determined to be an unnecessary and unfair restriction on our business activities in the West. An analagous suggestion would be that any relief from the diligence requirements of sections 3 and 7 only be available to Mr. Holsten's coal company in those regions of the West where his parent company has no incentive to sit on the coal leases while it devotes development efforts to other energy fuels.

As to timing, I see no reason for action on section 2(c) to proceed separately from sections 3 and 7. The companies, such as mine, which are presently prevented from holding federal coal leases can find just as many objections to repeal of sections 3 and 7 from the standpoint of their own business interests as our competitors have found concerning the repeal of section 2(c). Repeal of sections 3 and 7 would make the situation even less competitive from our standpoint than at present. Indeed, it may well be that the repeal of section 2(c) has more urgency from our standpoint, because a lease sale may be held even sooner than the December 31, 1986 deadline that the proponents of repeal of section 3 are concerned about.

8. Please comment on Mr. Holsten's testimony that Lee Ranch Mine was "put into operation knowing 2(c) is in effect."

Mr. Holsten's statement is misleading, and most charitably characterized as a half truth, in that it implies that we knew that we were not eligible to obtain federal coal leases at the time the Lee Ranch Mine was planned because section 2(c) was on the books. That is not so. At the time the Lee Ranch Mine was planned, permitted and the coal committed to sale, the policy of the Interior Department was that companies like SF Coal Corporation could hold federal leases provided they were not the alter ego of their railroad affiliate. At that time lease sales were planned for the area of the Lee Ranch Mine by the Interior Department and we fully expected we would get an opportunity to bid competitively for the fill-in federal coal land in the Lee Ranch mining block, especially since Interior had in June 1982 approved the assignment of two federal coal leases to us as permissible under 2(c). However, in December of 1982, largely at the instigation of our competitors, Interior Department Solicitor Coldiron reversed a number of decisions by previous Solicitors and held that rail affiliated coal companies would no longer be permitted to bid on federal coal leases. Underscoring the discretionary nature of that interpretation, it was made effective only on a prospective basis, and we still hold our two federal coal leases. A copy of that decision is enclosed for inclusion in the hearing record.

9. Mr. Holsten suggests in his testimony that SF Minerals has not been leasing its coal, but waiting for the repeal of 2(c). How much coal does SF minerals control? Of this, how much is under lease or committed to a purchaser?

Mr. Holsten's suggestion that SF Minerals has been sitting on its coal waiting for the repeal of 2(c) is ridiculous. Of the approximately 816 million tons of coal reserves known to exist on lands controlled by SF Minerals, approximately 506 million tons are leased to other non-related companies, including Mr. Holsten's company, and SF Minerals or its affiliated companies have no control over the production or marketing of that coal. Of the remaining 310 million tons, approximately 250 million tons are in the Lee Ranch mine area and are being held in support of the $100 million investment we have made in that operation. The remaining 60 million tons are not currently committed to anyone. We attempted to include it in an exchange we have pending with the BLM but it was rejected by the BLM for various reasons. We are certainly open to proposals from Mr. Holsten's company or anyone else ready and willing to undertake coal production and marketing of these uncommitted reserves. In summary, only a small percentage of our known recoverable coal reserves are presently uncommitted, comprising less than 1 percent of the total uncommitted coal reserves in what the Justice Department defines as the Southwest coal region, much less the larger area in which we compete.

10. During the question period after your testimony, Senator Ford read an excerpt from testimony before the Linowes Commission by Donald Young, Director of the ICC's Bureau of Accounts. In that excerpt Mr. Young stated: "Except in the case of agricultural commodities or challenges by courts, the Commission may not disapprove a contract because a rate unreasonably discriminates against some other shipper. Therefore, it is possible that a rail carrier could negotiate a contract rate with its mining subsidiary which was significantly lower than the rates charged to other coal shippers." Given Senator Ford's concern and Mr. Young's statement, would you be willing to consider a statutory requirement that a procedure and remedy identical to the agricultural commodities procedure and remedy shall be available to competing coal producers whenever you hold a federal coal lease within your railroad affiliate's exclusive service area?

I am not very well informed as to the provisions of the agricultural commodities clause. From our mining companies' point of view, we do not have any objection to any type of rate disclosure provisions that could be agreed to by our customers and the Santa Fe Railway, as long as it would not infringe on our right to make confidential bids to potential purchasers. Indeed, in our early discussions with the American Mining Congress task force created to consider a possible compromise on section 2(c) our lawyers discussed the possibility of adapting the agricultural commodities provision to cover shipments of federal coal from leases held by rail affiliated coal companies. However, we felt that the committee jurisdictional problems raised by attempting to amend the Interstate Commerce Act might bog down the pending coal leasing legislation. The approach contained in Senator McClure's amendment avoids that problem and affords our competitors what we believed, in light of their well publicized views about the ICC, they would view as a preferable forum for contract and bid disclosure proceedings.

11. In Mr. Holsten's testimony he said he had requested an opportunity to discuss "transportation and . . . antitrust" issues concerning section 2(c) with your holding company or railroad affiliate. He added that "to date, any request for such a meeting has been denied us". Please confirm whether such a request was made to your holding company or railroad affiliate and describe both the nature of the request and any response made by the parent or affiliate.

Mr. Holsten has never asked me or any representative of our coal company to arrange a meeting with our holding company nor with our railroad affiliate. If he has made any such request directly to those companies I am unaware of it and I believe I would have been informed if such a request had been made.

B. Questions Submitted by Senator Bumpers

1. Why should railroads and their mining affiliates be given the right to lease federal coal when they have opposed development of alternative forms of transportation, such as coal slurry pipelines?

My views on the coal slurry controversy are as follows. As a coal miner I am interested in our coal being transported in the most economical manner. I would welcome anything that would increase the area within which my coal can compete. As an engineer I am aware that a coal slurry pipeline only makes sense when large quantities of coal are to be transported from one point which has an abundant supply of excess water and a large supply of coal, to a single delivery point which can dewater the coal and consume the large quantities necessary to justify the pipeline. In my own experience I have not seen a place in the west where all of these conditions are present. I might also comment that an affiliated company of SF Minerals currently operates the only commercial coal slurry pipeline in operation in the United States and I am advised that our parent company would certainly be interested in expanding that business if the opportunity arose for enhancing profits from that source.

My coal companies have not been involved in any of the legislative battles over coal slurry legislation in recent Congresses. However, Santa Fe Railway has supported the railroad industry position in opposition to such legislation. I am advised that it was their view that the various legislative proposals to confer federal eminent domain authority on coal slurry pipelines would create an unfair competitive advantage for such companies in enabling them to "skim the cream" of attractive coal hauls without having to assume the less economically attractive common carrier obligations that railroads must undertake. If that is so, in my view the difference between the enactment of coal slurry legislation and the repeal of 2(c) is that the former would give a competitive "leg up" to coal slurry pipelines vis-a-vis railroads, whereas the latter would simply put our coal companies on a common footing with our competitors.

It is also my understanding, from discussions with those who have been involved in the coal slurry legislative battles, that interest groups other than the railroads, principally agricultural and enviromental interests, were major factors in the defeat of coal slurry legislation and that they remain opposed to it. I am not able to assess the accuracy of that analysis, but if it is true then it seems to me that Santa Fe Railway's position on any future coal slurry legislation may be irrelevant to its success or failure. In any event, I see no justification whatsoever for linking it to the pending coal leasing legislation. Indeed, it is my view that the opponents of modification of section 2(c) are not interested in withdrawing their opposition to section 2(c) relief in return for railroad acquiescence in coal slurry legislation. It was never mentioned in our discussions with them over the summer nor in Mr. Holsten's testimony. I think they feel that, in light of the continued opposition of agricultural and environmental interests, coal slurry is a dead issue.

In summary, my coal companies would not get involved with coal slurry legislation. Santa Fe Railway advises me that they have no present position on coal slurry legislation, but would have to evaluate specific legislation, the position of the railroad industry and agricultural and environmental interests, and the legislative context in which it was presented before deciding on whether to oppose it or stay on the sidelines.

2. I understand that the independent coal companies and the railroad mining affiliates have been working together towards a compromise on Section 2(c) leasing provisions. It is also my understanding that requests made by the coal companies to meet with management of the railroad holding companies for discussions of transportation issues have been denied.

Is this correct?

If so, why were these requests denied?

Please refer to my answer to Question No. 11 in part A.

3. Please provide a statement on the positions of Union Pacific, Burlington Northern and Atchison, Topeka and Santa Fe railroads on coal slurry pipelines. Specifically, would they favor the grant of Federal eminent domain rights across rights-of-ways to slurry pipelines?

Please refer to my answer to Question No. 1 in this Part B.

C. Additional Questions Submitted by Senator Johnston

1. Why did you refer in your testimony to federal coal as "federal dole?" Do you think that federal royalty rates are too low?

No, I do not think the federal royalty rates are too low. My reference to the "federal dole" is misquoted. I believe the statement was "public dole", which was intended to point up the fact that the companies like Mr. Holsten's exist largely by making a profit from publicly owned coal.

* * *

13. Do you think that current market conditions support additional coal leasing at this time? Why or why not?

I see no harm in leasing any federal coal for which anyone is willing to pay bonus and rentals. I believe the market place will determine which coal is mined and when, and I fail to see where the public interest is served by attempting to hold federal coal off the leasing market in order to create some sort of a tight supply situation. There is already many times more coal leased than will be consumed in the West over the next 20 years and so long as the lease terms require reasonable diligence and reasonable payments for delay, I would be in favor of unlimited leasing of federal tracts in which an interest has been expressed by individuals or corporations willing to bid.

Questions for All Witnesses on Panel I

1. As you know, Senator McClure has introduced two amendments pertaining to Section 2(c) of the Mineral Leasing Act. One amendment would repeal that provision. The other apparently represents an effort to reach a compromise position on the issue. Could you support both amendments?

Yes, I can support either of the amendments proposed by Senator McClure, although I prefer the direct repeal of Section 2(c).

2. Do you think that complete repeal of Section 2(c) would have anti-competitive effects?

No. To the contrary, I believe it would increase competition in the western coal industry. This belief has been shared by the Justice Department, the Interior Department, the Linowes Commission and others in the past five administrations.

3. Do you think we could alleviate concerns about these anti-competitive effects in the area of coal transportation by moving forward with coal slurry legislation?

What are your views on coal slurry?

No. Please refer to my answer to Question No. 1 in Part B.

4. Senator McClure's Amendment No. 801 provides that railroads or affiliated companies leasing federal coal must comply with certain conditions (such as cooperative leasing and sharing of exploration data) only if the Secretary of the Interior finds that competition for the federal lease would

be "substantially enhanced thereby." What criteria do you think the Secretary should apply in making the determination that competition would be "substantially enhanced?"

Can you think of circumstances under which competition would not be substantially enhanced by the sharing of data or the guarantee of cooperative leasing?

The criteria for making the determination prescribed in Amendment No. 801 should be developed by rulemaking with full public participation. Generally, however, I believe the Secretary would simply have to make a determination that companies other than the railroad affiliated coal company involved would bid on the leases if cooperative leasing is required and that such other companies would not bid in the absence of cooperative leasing. This determination would presumably involve consideration of past interest in leasing federal coal or coal under other ownerships in the area (e.g., Indian, state or private), the existence of other coal mines in the area and potential customers, and other similar information upon which a reasonable judgment could be based as to whether anyone other than the rail affiliated coal company would be likely to bid on the federal coal. If evaluation of those factors would lead a reasonable person to conclude that no one else was likely to bid on the federal coal even if it were offered as a package with the coal owned by the rail affilate, then competition would not be "substantially enhanced" (indeed enhanced at all) by cooperative leasing.

5. Amendment No. 801 employs the term "potential mining unit." What criteria do you think the Secretary of the Interior should apply in designating "potential mining units?"

Should there be limitations on the size of the "potential mining units?" If so, what?

Again, the definition of "potential mining unit" should be developed by rulemaking with full public participation. Generally, I believe that it should include all of the coal that could reasonably be expected to be mined from a single or unified mining operation. In general, this would include all the coal that would be processed and loaded through a single loadout facility. The determination should be based on an engineering, economic and geologic showing as to the reasonableness of the size of the unit and, since coal mining conditions vary widely in the west, I would think an arbitrary maximum size, such as limits "logical mining units" under present law, would not be appropriate.

In conclusion, I appreciate the opportunity to amplify on my testimony and hope that the foregoing has been responsive and helpful.

Sincerely yours,

Richard T. Zitting

Richard T. Zitting
President

AVAILABLE

Santa Fe Mining, Inc.

4775 Indian School Road N.E., Suite 100
P.O. Box 2588
Albuquerque, New Mexico 87190
505/262-2211

October 25, 1983

Mr. David F. Linowes, Chairman
Commission on Fair Market Value Policy
For Federal Coal Leasing
Suite 400
1015 20th Street, N.W.
Washington, D.C. 20036

Dear Chairman Linowes:

Santa Fe Mining, Inc. (SFM) is pleased to respond to your invitation to assist in the Commission's review of fair market value statutes, policies, and procedures for Federal coal leasing. I am authorized to make this statement on behalf of SFM and its affiliated and subsidiary companies in the mining, land holding, and coal business, including Santa Fe Pacific Railroad Company (SFPR), SF Coal Corporation (SF Coal), Hospah Coal Company, and Pintada Coal Company. The viewpoints of these companies bring what is perhaps a unique perspective to your proceedings as these companies are involved in all facets of western coal development and production:

> SFPR, Hospah, and Pintada are major lessors of privately held coal, having separately developed and leased some 500 million tons of proved coal reserves for mining;
>
> SFM is the holder of Federal coal leases while SFM, Hospah, and Pintada hold rights to New Mexico State Coal Leases;
>
> SFPR is processing a fee-for-fee coal exchange with the Bureau of Land Management pursuant to Section 206 of the Federal Land Policy Management Act of 1976 (FLPMA); and
>
> SFM and SF Coal have developed and SF Coal soon will be producing from the Lee Ranch surface coal mine in the San Juan Basin of New Mexico, which mine has a Surface Mining Control and Reclamation Act (SMCRA) permit allowing production of up to five million tons per year of private and State-leased coal.

Ironically, despite these accomplishments and our continuing program of exploration and development of coal and other minerals, we get more attention from some elements of the coal industry due to our indirect affiliation with a common carrier railroad, The Atchison, Topeka and Santa Fe Railway Company (Santa Fe Railway). SFM, SFPR, SF Coal, Hospah, and Pintada are not in the transportation business, but are in the coal business. In order to compete effectively in the coal business, we need to compete for Federal coal. This Commission has heard many times during your hearings of the predominant position of the United States Government in western coal, both in terms of the sheer tonnages involved and the indirect control of other reserves due to the interspersing of Federal coal with state and fee coal. See also, U.S. Department of Justice, Competition in the Coal Industry 24 (May, 1979). Some of our coal competitors, however, seek to preclude us from competing for Federal coal leases. The straw they are clutching to is Section 2(c) of the Mineral Leasing Act, a 1920 statute precluding companies operating common carrier railroads from holding Federal coal leases, except for railroad purposes. 30 U.S.C. § 202. Although SFM, SFPR, SF Coal, Hospah, and Pintada do not operate a common carrier railroad, the National Coal Association (NCA) has tried for years to extend the Section 2(c) prohibition to all companies affiliated with a railroad. Not only has the NCA sought to insulate its members from competition by advancing this questionable application of Section 2(c), it now has taken the additional illogical step of arguing that Section 2(c)'s prohibition on leasing also acts to bar exchanges of coal lands otherwise authorized by Section 206 of FLPMA between the United States and coal companies affiliated with railroads.

While the NCA urged at the Commission's hearings that the Federal government should "maximize competition at all levels," it later demonstrated in its testimony that it meant competition by all but one segment of the coal industry, coal companies affiliated in some way with a railroad. We demonstrate here the fallacy of the NCA arguments and urge that all companies be allowed to compete freely for Federal coal to ensure the United States receives true fair market value for its coal resources.

The Public Interest is Best Served by a Competitive Market for Federal Coal

By promoting a competitive market for Federal coal leases, the Federal government would be assured of receiving fair market value for its coal resources and the general public interest would be advanced. In order for the leasing process to be competitive, two factors must be present: (1) a large number and variety of coal tracts must be offered; and (2) the bidding process must be open to all.

As the dominant coal owner in the West, the Federal government has disproportionate control over the market for coal. If inadequate amounts of Federal coal are available for leasing, the competitive process is undermined, with companies holding existing leases or PRLA's having the upper hand and new companies foreclosed from entering the market. Department of Energy, Coal Competition: Prospects for the 1980's 157 (January, 1981) (Draft Report). Unless the availability of an adequate amount and variety of Federal coal can be assured, a distorted pattern of development will arise in which the avoidance of Federal coal becomes a more dominant consideration influencing mining decisions than geologic, economic, or environmental factors. After 1973 nine surface coal mines have been permitted in New Mexico but none has included Federal deposits. Privately owned deposits are not always large enough to justify a financial commitment without the possibility of also obtaining adjacent Federal coal. In other cases, especially in the so-called "checkerboard" areas, Federal coal may be by-passed during the mining of contiguous private deposits and rendered economically unmineable.

The Secretary of the Interior's 1971 moratorium on coal leasing and the present complex coal leasing process have limited artificially the amount of coal reserves available to a new competitor seeking a foothold in the market. Another governmentally-imposed barrier to entry in the coal industry is Section 2(c) of the Mineral Leasing Act. This statute effectively removes one source of potential competition for Federal coal sold competitively and thereby reduces the level of competition for Federal coal.

Repeal of Section 2(c) of the Mineral Leasing Act Will Increase Federal Lease Sale Revenues By Enchancing Competition For Federal Coal

Section 2(c) of the Mineral Leasing Act is an anticompetitive and anachronistic barrier to the optimum development of Federal coal resources. It is obviously anticompetitive--it was designed to discriminate against one industry--railroads--and today operates to impede competition in the coal industry by railroads and, perhaps, their affiliates. Section 2(c) is also a relic of an earlier era. Whatever dominant position railroads may have had in the American economy in 1920 now has been lost. Repeal would allow new competition into a market increasingly dominated by major oil companies, electric utilities, and large coal concerns. Office of Technology Assessment, An Assessment of Development and Production Potential of Federal Coal Leases 385 (December, 1981). Subsequently enacted statutes and regulations prevent and control any potential for anticompetitive abuse by railroads or others in the production or transportation of coal. These statutes are better suited to protect legitimate public concerns than is the overbroad prohibition of Section 2(c).

In 1970, the Public Land Law Review Commission concluded that the restrictions upon the leasing of Federal coal to railroad companies should be removed:

> The fears of monopolistic control which led to the enactment of existing restrictions no longer are applicable. The importance of pipelines and truck transportation and the growing use of mine-mouth generation have materially reduced any competitive advantages railroads may once have had over other coal producers. Furthermore, it appears that other Federal laws, such as the antitrust laws, are far more effective in regulating the competitive position of the railroads than the public land laws.

One Third of the Nation's Land, Report of the Public Land Law Review Commission at 136 (1970).

Under both the Carter and Reagan Administrations, the Departments of the Interior and Justice have agreed that Section 2(c) no longer serves any useful purpose and should be repealed. After intensive study of competitive conditions for western coal, the Department of Justice addressed the issue squarely:

> Plainly, whatever the merits of a general prohibition on leasing to railroads in 1920, the broad sweep of Section 2(c) is now an impediment to rather than bulwark of competition. The Department therefore recommends that Section 2(c) be repealed.

U.S. Department of Justice, Competition in the Coal Industry 89 (1980). The Interior Department's most recent statement before Congress in support of repeal is set out in Hearings on Section 1542 before the Subcommittee on Energy and Mineral Resources of the Senate Committee on Energy and Natural Resources, 97th Cong., 1st Sess. 10-15 (1981).

The need for repeal of Section 2(c) has become more urgent since the Interior Department's December, 1982, reinterpretation of the scope of Section 2(c). By this reinterpretation, the Interior Department receded from its earlier interpretation that leasing was permissible to energy firms that are corporate affiliates of railroads and it thereby resolved the inconsistent positions of the Interior and Justice Departments on this issue. Under the present interpretation of the scope of Section 2(c), SF Coal would be precluded from competing in the upcoming San Juan Basin coal lease sale unless it were able to secure legislative or judicial relief from the mininterpretation of the statute. At the same time the Interior Department issued its reinterpretation (applied prospectively), however, it stressed its continuing strong support for repeal of Section 2(c). The Interior Department supports repeal in order to maximize competition for Federal coal leases and to improve the Department's ability to manage Federal coal resources held in checkerboard ownership patterns with railroads or their affiliated companies. 128 Congressional Record E 5275 (daily ed. December 17, 1982) remarks of Rep. Lujan and letter from the Department of the Interior).

Repeal of Section 2(c) undoubtedly would enhance competition for Federal coal and increase Federal coal lease sale revenues. Higher bids can be expected when potential bidders are not excluded from the bidding process. Further, new coal lands will be freed to be leased and developed. Individual or isolated sections of land often do not contain enough coal to support a modern western surface mining operation and they consequently attract low bids if any. When these lands can be consolidated with other lands into a logical mining unit (LMU), their worth to a potential bidder increases. A larger mining operation using larger, more efficient equipment results in lower unit production costs, especially where equipment does not have to be moved and new pits dug in order to mine non-contiguous tracts. A bidder will pay more for a Federal tract which may be unitized with its existing coal rights (e.g., Federal or states leases, PRLA's, privately-owned coal, coal leased from railroads or their affiliates, etc.) because assembly of a consolidated tract would reduce its overall cost per ton mined.

The NCA suggests that railroad-affiliated coal companies would have an economic advantage when competing with others in the "checkerboard" areas. Removing the strictures of Section 2(c) would not grant us an unfair advantage over other coal companies. Many of these companies, we should point out, have leased large deposits from railroad-related companies. The geological dispersion of coal deposits together with the Federal law (30 U.S.C. § 184) acreage limitations on which leases, applications, or bids may be taken, held, or controlled (46,080 Federal acres in any one state and 100,000 acres overall), will ensure that no company will assume a dominant position. If anyone has an economic advantage, it is those members of the coal industry who have been sitting on pre-FCLAA leases or PRLA's (for which no bonuses were paid). According to the Office of Technology Assessment (OTA), as of late 1980, there were 249 Federal leases covering nearly 338,000 acres and containing 6.6 billion tons of recoverable reserves that were undeveloped (no mine plan had been submitted to the Department of the Interior). Office of Technology Assessment, An Assessment of Development and Production Potential of Federal Coal Leases 3 (December, 1981). This represented some 44% of all Federal leases. Id. at 15. As of January 1, 1980, 176 PRLA's covering 404,000 acres and containing 5.8 billion tons of recoverable reserves were in existence. Id. at 7. Clearly these holdings, together with private and State-lease reserves, give the established companies in the coal industry an advantage in competing for new leases on adjacent properties.

The coal producers' lobby also has alleged that western railroads have a "monopoly" and may therefore discriminate unfairly against non-railroad affiliated coal companies. The Department of Justice's 1980 Competition in *the Coal Industry* report specifically addressed this concern and concluded that no special restriction on leasing to western railroads is warranted. In the San Juan Basin, for example, one area in which SF Coal competes, no railroad has a monopoly. Since utilities, the principal purchasers of coal produced in the Southwest, make their purchasing decisions on the basis of the lowest fuel supply delivered cost they can negotiate with coal producers and transportation companies, competition from other fuel types--oil, natural gas, lignite, and uranium--and competition from other coal producing regions in the Southwestern United States and from the Powder River Basin all prevent any coal producer or supplier of coal transportation from achieving a monopoly position. Further, truck transportation, along with the possibility of other common carrier railroad transportation, pipelines, private carrier railroad transportation, and mine-mouth power generation all provide existing or potential competition to railroads as they compete for transportation of coal traffic. With so much competition for coal transportation, it should not be surprising that the Justice Department concluded, in its 1980 Report, at 32, that no railroad in the "Southwest coal production market" has market power over the transportation of coal. This conclusion is still valid today. No railroad has market power over coal transportation, and therefore, no railroad possesses a monopoly over coal transportation.

In addition, the Justice Department has concluded that the antitrust review procedure of Section 15 of the FCLAA provides adequate safeguards against potential abuses. This 1976 legislation requires the Attorney General to review proposed acquisition of leases on a case-by-case basis to determine whether the lease will create a situation inconsistent with the antitrust laws. SFM's application had to withstand this scrutiny before it was entitled to receive its two Federal coal leases by assignment.

The Staggers Rail Act does not, as suggested by the NCA, give railroads any unfair competitive advantages in negotiating coal rates or rail transportation service with shippers of coal. The Staggers Act merely gives railroads freedom to negotiate with coal shippers so that market factors, rather than government regulation, can determine the price and quality of coal transportation by rail. As a recent study prepared by the Department of Energy concluded, "the new flexibility under the Staggers Act encourages price competition to a much greater degree than in the past . . ." Department of Energy, *Report on Potential for Cost Reduction in Inland Transportation of U.S. Coal Exports* xii (August, 1983). Further, under the Staggers Act, any railroad which is found by the Interstate Commerce Commission (ICC) to be market-dominant in the transportation of coal would be prevented from setting or maintaining unreasonably high rail rates. In testimony before the ICC on September 7, Mr. Young of the Interstate Commerce Commission (ICC) discussed the type of concerns raised by the NCA and concluded that the ICC's statutory authority, including its power to review rates and reject contracts, together with enforcement of the antitrust laws by the Justice Department, are adequate to ensure that railroads could not abuse any market power in coal transportation in order to manipulate the market for coal.

Coal Land Exchanges Under FLPMA Should Be Used In Certain Mixed Ownership Situations To Assemble Attractive Lease Units and Thereby Maximize the Value Received for Federal Coal

In some mixed ownership situations, the best way to assemble a LMU that will attract competition is to use a coal-for-coal exchange under Section 206 of FLPMA. By exchanging coal in this way, at least two consolidated units--one which is privately owned and one comprised of Federal coal which can be leased competitively--can be assembled where formerly tracts were interspersed in such a way as to make separate mining operations difficult if not uneconomic.

An example of where a coal exchange under FLPMA can maximize the value received for Federal coal is SFPR's proposed exchange of coal interests with the Bureau of Land Management in eastern McKinley County, New Mexico (the McKinley County Exchange). This exchange will create single ownership tracts of coal in an area where SFPR coal tracts are now intermingled with Federal coal tracts. As the exchange is now structured, SFPR would receive Federal coal rights for approximately 102 million tons of coal with a stripping ratio of 9.3:1 on approximately 4,500 acres and the Federal government would receive 98 million tons of coal with a stripping ratio of 7.9:1 on approximately 6,800 acres now owned by Santa Fe. No surface rights are involved. The resulting blocks of Federal coal will be in an area with surface owner consent free from environmental conflicts. Higher bids can be expected on these Federal blocks when they are offered for leasing because contiguous sections of land will be assembled into LMU's.

Exchanges under Section 206 of FLPMA are statutorily required to be "equal value" exchanges; the coal interests offered by the United States and the private party must be approximately equal. Yet both sides benefit by having a consolidated tract of coal. Section 206 exchanges do not result in low bonus bids during a slack coal market. Regardless of market conditions, exchanges will involve the trading of tonnages of equal value, resulting in units that may be mined in the most economically efficient and environmentally sensible manner and that will attract higher bonus bids when put up for sale. Such exchanges may only be consummated when the Secretary finds them to be in the public interest.

The NCA has opposed exchanges involving railroad affiliated coal companies on the grounds that they are "anticompetitive" and in violation of "the spirit" of Section 2(c) of the Mineral Leasing Act. While the coal exchange SFPR has proposed will create a more efficient mining unit at the Lee Ranch Mine and therefore be procompetitive, it also will permit other coal producers to enhance their competitive positions by bidding on larger tracts of blocked up Federal coal, with the result that competition will be stimulated. This result could only be called "anticompetitive" in the distorted sense that NCA uses that term; i.e., to mean any action that would mean increased competition with its members. That is the kind of economic protectionism the law tries to prevent, not to promote.

Section 2(c) plainly has no application to exchanges under FLPMA, even assuming it was judicially established that Section 2(c) applies to railroad-affiliated coal companies. In enacting Section 2(c), Congress simply restricted the leasing of Federal coal to railroad companies; it did not restrict any other method of transferring Federal coal to railroads or their affiliated corporations.

In conclusion, we believe that fair market value for Federal coal can be achieved only through a competitive market. We believe the Federal government should lease substantial reserves under flexible terms which encourage development in order that normal supply and demand forces can freely work to set a fair market price. Such a process must be open to all companies; in this respect, Section 2(c) is clearly an outdated and unneeded barrier to competition. Over the years this provision has artificially restricted the number of firms competing for Federal coal and has likewise limited the amount of land available for coal production. We also urge the use of coal-for-coal exchanges under FLPMA in order to promote competition through the assembly of more efficient mining units. Stimulating competition for coal by opening up the process to all companies is in the public interest; protecting the entrenched positions of existing coal producers by excluding competition clearly is not.

Thank you for this opportunity to offer SFM's views and those of its affiliated and subsidiary companies in the coal business. All of these companies would be glad to offer what further assistance you may require.

Sincerely yours,

R. T. Zitting

R. T. Zitting
President

RTZ/gem

December 6, 1982

Generally—Coal Leases and Permits: Generally—Mineral Act: Generally

When the Secretary changes his construction of an ambiguous statutory provision for reasons of policy and law, the new construction operates prospectively only, and does not operate to invalidate actions (issuance of leases and approval of lease transfers) previously taken.

Safarik v. *Udall*, 304 F. 2d 944 (D.C. Cir. 1962), applied; *Enfield* v. *Kleppe*, 566 F. 2d 1139 (10th Cir. 1977), distinguished.

OPINION BY SOLICITOR COLDIRON

OFFICE OF THE SOLICITOR

MEMORANDUM
To: SECRETARY
FROM: SOLICITOR
SUBJECT: RAILROAD AFFILIATES AND COAL LEASING

INTRODUCTION

Recent increases in coal leasing activities by the Department require a critical reexamination of section 2(c) of the Mineral Lands Leasing Act, 30 U.S.C. § 202(c) and the conflicting positions adopted by this Department and the Antitrust Division of the Justice Department. For the reasons set forth below, I conclude that both interpretations of this ambiguous provision are lawful and judicially defensible, and the Secretary has the authority to change his interpretation prospectively. Further, I recommend that this Department abandon the alter ego test previously adhered to, and maintain that section 2(c) prohibits certain railroad affiliates from holding federal coal leases.

BACKGROUND

Section 2(c) of the Mineral Lands Leasing Act (Leasing Act), 30 U.S.C. § 202,[1] provides in relevant part:

> No company or corporation operating a common-carrier railroad shall be given or hold a permit or lease under the provisions of this Act for any coal deposits except for its own use for railroad purposes; [with express limitations for acreage holdings for coal leases used for railroad purposes].

This provision was interpreted in a Solicitor's opinion dated May 18, 1976, captioned "Colowyo Coal Project." The Solicitor advised the Under Secretary that this provision was narrow in scope, and the prohibition applied only to companies "operating" a railroad. He concluded that the prohibition applied to a corporate affiliate of the company operating a railroad only when the affiliate was the "alter ego" of the operating company. The Solicitor concluded that the Colowyo Coal Company could hold a federal lease, because it was not an "alter ego" of the Escanaba and Lake Superior Railroad, a subsidiary of a subsidiary of the parent of one of the two companies in the Colowyo partnership.

The "Colowyo Coal Project" opinion reached two major conclusions. First, it concluded that the legislative history of section 2(c) showed the intent of Congress to limit its scope to companies operating railroads, and to exclude affiliates from its coverage. Second, he concluded that section 2(c) was in drafting and history, and therefore in interpretation, identical to the Commodities Clause of the Hepburn Act, 49 U.S.C. § 1(8), which the Supreme Court had construed not to prohibit railroads from transporting their corporate affiliates' goods. *United States* v. *Delaware & Hudson Co.*, 213 U.S. 366, 414-15 (1909). In 1979, the Associate Solicitor, Energy and Resources, agreed with the "Colowyo Coal Project" opinion, emphasizing the first of these two conclusions. Memorandum of January 4, 1979, to Assistant Secretary, Land and Water Resources, "Section 2(c) of the Mineral Lands Leasing Act, 30 U.S.C. § 202."

---

[1] As enacted, the provision at issue was a proviso within section 2 of the Leasing Act, 30 U.S.C. § 201. 41 Stat. 438. It was labeled section 2(c) of the Leasing Act by section 1 of the Act of June 3, 1948, 58 Stat. 275, which did not amend the substance of the provision.

On April 25, 1980, the Antitrust Division of the Justice Department issued a "Memorandum Concerning Section 2(c)" (Antitrust Division Memorandum), which was sent to Interior by the Assistant Attorney General on May 5, 1980, and the substance of which was included in the Justice Department's annual report to Congress for FY 1979, "Competition in the Coal Industry" 81-88 (November 1980), under section 8 of the Federal Coal Leasing Amendments Act of 1976, 30 U.S.C. § 208-2 (1976). In this memorandum, the Antitrust Division disagreed with both of the conclusions of the May 18, 1976, "Colowyo Coal Project" opinion. The Antitrust Division rejected the first of the Solicitor's conclusions by emphasizing early congressional debates on railroad participation in the federal coal leasing system. These debates establish the theme that Congress intended to separate the transportation of coal from its production. *E.g.*, 51 Cong. Rec. 15180-83 (1914). It is in light of this history that the Antitrust Division construed the debate on the adopted provision, reaching the conclusion Congress intended to prohibit railroad affiliates, as well as companies operating railroads, from holding federal coal leases. With respect to the second of the Interior conclusions, the Antitrust Division concluded that the Commodities Clause cases "are not a persuasive basis for intepreting 2(c). The rationale of *Delaware & Hudson* has been thoroughly discredited by more recent Supreme Court decisions." Antitrust Division Memorandum at p. 19.

No further Interior Department opinions followed that 1980 Antitrust Division memorandum (see letter of January 16, 1981, from Solicitor Martz to Assistant Attorney General Litvack, Antitrust Division), chiefly because the Justice Department's November 1980 report to Congress advocated the repeal of section 2(c) as an anachronism no longer necessary to prevent anti-competitive practices. Both the Interior and Justice Departments endorsed the repeal of section 2(c) in the 97th Congress. See letter of January 5, 1982, from Assistant Secretary Carruthers to Senator McClure on S. 1542. In the absence of Congressional action, however, the continued, adverse intrusion of section 2(c) into the conduct of the federal coal leasing program, and into the promotion of development of federal coal found in mixed ownership with the land grant railroads, has warranted re-examination of these issues.

THE AMBIGUITIES IN SECTION 2(c)

Both of the issues on which Interior and Antitrust Division have opined are issues which have more than one reaonable interpretation. Both Departments' view of each issue is reasonable, as the Antitrust Division recognized (Antitrust Division Memorandum at p. 3). Both views can be inferred from the literal words of the statute and the context in which they are used, and neither is repudiated by contemporaneous agency construction or authoritative judicial interpretation. "[W]hile the clear meaning of statutory language is not to be ignored, 'words are inexact tools at best,' *Harrison* v. *Northern Trust Co.*, 317 U.S. 476, 479 (1943), and hence it is essential that we place the words of a statute in their proper context by resort to the legislative history." *Tidewater Oil Co.* v. *United States*, 409 U.S. 151, 157 (1972). We examine first the history of the adoption of section 2(c) in the Leasing Act.

A. *Congressional intent and the legislative history.* Various bills to enact a mineral leasing law were introduced into Congress before passage of the Leasing Act in 1920. In 1914 Congress considered versions of what was to become the section 2(c) prohibition against railroad leasing which contained the sentence, "The term 'railroad' or 'common carrier' as used in this act shall include any *company or corporation owning or operating* a railroad, whether under a contract, agreement, or lease, and *any company or corporation subsidiary or auxiliary thereto,* whether directly or indirectly connected with such railroad or common-carrier." 51 Cong. Rec. 15177 (1914) (italics added). In 1919 Senator Smoot had introduced a bill, S. 1269, that contained a similar, broadly-stated prohibition. When this bill was reported out of the Senate Committee on Public Lands as S. 2775, it contained the prohibition against railroad which in substantial part was enacted in the Leasing Act. During the Senate debate on S. 2775, Senator LaFollette introduced an amendment to broaden the prohibition, although its phrasing differed substantially from that quoted above. 58 Cong. Rec. 4591 (1919). To explain why the broader prohibition was no longer in S. 2775, and to oppose Senator LaFollette's amendment, Senator Smoot quoted from a letter that Gifford Pinchot, then President of the National Conservation Association, wrote regarding S. 1269 as it stood in committee. Senator Smoot explained that the broader definition of railroad (for both prohibition and relief purposes) was changed by the Committee in response to Mr. Pinchot's argument, "It is evident that if the relief is given fairly and squarely to common carrier railroads, the full purpose of the Act will be accomplished; and if an attempt is made to do more, we cannot foresee the consequences." 58 Cong. Rec. 4591 (1919). This argument is Delphic, and divergent interpretations of this letter have in part resulted in the divergent interpretations of section 2(c).

In 1980, the Antitrust Division concluded that Cognress, in adopting Mr. Pinchot's language, sought to limit the ability of a railroad affiliate to hold under section 2(c) "for its own use", without implying that railroad affiliates were exempt from the leasing prohibition. In its 1976 and 1979 opinions, Interior concluded that Congress, in adopting Mr. Pinchot's language, sought to exclude railroad affiliates from section 2(c) entirely, and thus make them subject to the limitations of section 27 of the Leasing Act, 41 Stat. 448, which then limited any corporation *and its affiliates* to one federal coal lease of 2,560 acres per state. Here, both agencies correctly focused on the relief given to railroads by section 2(c), to hold leases to supply coal for locomotive uses. In interpreting the substitute, however, the Antitrust Division focused on the primary Congressional purpose, separation of mining and transportation, while Interior focused on the interrelation of section 2(c) with section 27 of the Act, which then provided strict "anti-monopoly" acreage holding limits on federal leases for coal and other minerals.

The Antitrust Division examined the changes made in the wording of the bill that was introduced and concluded the changes further restricted leasing of federal coal to railroads. Antitrust Division Memorandum at p.10. Interior considered those changes to be cosmetic once affiliates were excluded from the scope of section 2(c).[2] Interior regarded the crucial changes to be the amendments to section 27 (which to it governed rail affiliates after the Pinchot substitute was adopted) in 1948, 1958 and 1964, when Congress increased the coal acreage and lease holding limits that Mr. Pinchot ostensibly wanted to apply to affiliates instead of the relief of section 2(c).[3] In rebuttal to Interior's reliance on the import of section 27, the Antitrust Division points out that the relationship was never expressed in the debates.

Which of these two views Mr. Pinchot intended when he wrote the Delphic lines quoted above is unknown. In fact, that there were "two views" how the revised provision should be interpreted may never have occurred to the debaters, since the precise means by which Mr. Pinchot's formulation assured that railroad affiliates could not benefit from section 2(c)'s "relief" provision was irrelevant until after 1948, as the acreage limits in section 27 of the Leasing Act were changed. Only then did the question of whether affiliates had been excluded from the operation of section 2(c) take on significance.

---

[2] The Antitrust Division regards this as an implicit conclusion by Interior that Congress inadvertently narrowed the prohibition. Antitrust Division Memorandum at p. 13. To Interior, the conclusion was express and the Congress acted knowingly, in the sense that the Committee understood that the scope of the relief as well as the prohibition in section 2(c) was narrowed by the deletion of any express reference to railroad affiliates.

[3] Act of June 3, 1948, sec. 6, 62 Stat. 291; Act of Aug. 21, 1958, 72 Stat. 689; Act of Aug. 31, 1964, 78 Stat. 710. The holding of leases by railroads for railroad purposes "used up" the acreage allowed to railroad affiliates, because of section 27's attribution of a lessee's holding to all of the lessee's affiliates. 41 Stat. 448. As these acreage limits were raised, railroad affiliates became eligible to hold acreage above and beyond the acreage held by the railroad for railroad use, but charged under section 27 to the affiliate. See 30 U.S.C. § 184(a), as amended.

The context in which the debate occurred further obscures the matter, and bolsters the conclusion that there is no definitive and unambiguous interpretation. Senator Smoot convinced Senator LaFollette to withdraw his amendment, and thus no vote ever occurred that clearly repudiated inclusion of auxiliaries and affiliates in section 2(c). He persuaded Senator LaFollette largely by offering, and getting passed, a further restriction on the relief accorded companies operating common carrier railroads, namely, the restriction to holding one lease per 200 miles of tract. The quoting of the Pinchot letter, see 58 Cong. Rec. 4591–92 (1919), resulted only in an hour long speech by Senator LaFollette. In this context, no solid inference about Congressional intent on the meaning of Mr. Pinchot's amendment may be drawn. The only conclusion that can be drawn, with caution, is that Congress narrowed the relief given by section 2(c) in the several amendments the Senate made in 1919. Again, this does not provide any instant answer for the question of the treatment of entities not expressly covered by the words of section 2(c).

On this issue, the Antitrust Division concluded, applying a "plain meaning" test, that section 2(c) "would seem to" prohibit railroad affiliates from holding federal coal leases. Antitrust Division Memorandum, Executive Summary at p. 1. In his May 18, 1976, opinion on the Colowyo coal project, the Solicitor found section 2(c) inapplicable where there was at best a remote connection between the railroad company and the coal lessee. In the Colowyo case, the lessee was a partnership of two corporations. One partner was a wholly-owned subsidiary of Hanna Mining Company of Cleveland (Hanna). Hanna owned a different subsidiary corporation which in turn owned all the stock in the Escanaba and Lake Superior Railroad. The 1976 "Colowyo" opinion reached a common sense conclusion that Colowyo itself did not, by any stretch, operate a common carrier railroad, and thus that no "plain meaning" rule would disqualify Colowyo Coal Company from holding a federal lease.

At the same time, however, the contemporaneous history of congressional opposition to mixing transportation and mining of federal coal argues against Interior's "plain meaning" interpretation that *no* corporate affiliate is subject to the prohibition unless it is the "alter ego" of a company operating a common carrier railroad. In fact, the Department's administration of section 2(c) supports no "plain meaning" view at all. The earlier Interior Department decision under section 2(c), *Sheridan-Wyoming Coal Co.*, A-24158 (October 11, 1945), was distinguished in the 1976 "Colowyo Coal Project" opinion. Under analysis, however, its impact on interpreting section 2(c) is to support the conclusion that the provision is ambiguous. The October 1945, decision dismissed a motion for rehearing of a May 21, 1945, Departmental order that a lessee (Sheridan Wyoming) show that its parent companies were no longer affiliated with a railroad. The May 21, 1945, order appears to have been Interior action consistent with the Antitrust Division's current position, although it was rendered moot (and arguably without precedential value) by stock transactions not directly occasioned by the Department's order. In any event, *Sheridan-Wyoming* was *not* relied on in the "Colowyo Coal Project" opinion as the authority for the "alter ego" test. The basis for that test was the Commodities Clause. 1976 Colowyo Opinion at p. 7.

B. *The Commodities Clause.* With respect to the Commodities Clause issue, Interior in 1976 relied on the fact that when section 2(c) was enacted, *United States* v. *Delaware & Hudson Co.*, *supra*, was neither old nor stale, and stood for the proposition that "stock ownership by a railroad company in a *bona fide* corporation, irrespective of the extent of such ownership, did not preclude a rail company from transporting the commodities . . .." 213 U.S. 366, 414–15 (1909). Further, the Commodities Clause was to Interior broader than section 2(c) (as revised at the suggestion of Mr. Pinchot), in that the former prohibited a railroad from transporting any commodity "which it may own in whole or in part, or in which it may have an interest, direct or indirect . . .." 49 U.S.C. § 1(8). Thus if the Commodities Clause did not apply to rail affiliates, *a fortiori* section 2(c) did not. Finally, Interior relied on the fact that Congress, in its deliberations on the Commodities Clause, rejected an amendment expressly covering railroad affiliates, history that the debate on section 2(c) seemed to imitate, and the Supreme Court in *Delaware & Hudson* had relied on this legislative history. "Colowyo Coal Project" opinion at p. 7.

For its part, the Antitrust Division maintained that the Commodities Clause is a dangerous analogy to use when construing section 2(c). First, it cited the commentators and later Supreme Court Justices who argued that *Delaware & Hudson* was wrongly decided, even while extending its shadow, "It is enough to say that if the Elgin [9] case was before us as a case of first impression, its doctrine might not now be approved. But we do not write with a clean slate." *United States* v. *South Buffalo R. Co.*, 333 U.S. 771, 774 (1948). With the *Delaware & Hudson* construction of the Commodities Clause so discredited, the Antitrust Division concluded, it would not be applied by analogy by any court construing section 2(c).

Second, the Antitrust Division pointed out that the Supreme Court was concerned in *Delaware & Hudson* that broad construction of the Commodities Clause would generate constitutional issues on the scope of the Commerce Clause which at the time were critical. 213 U.S. 366, 410 (1909). Aside from further support for the idea the *Delaware & Hudson* case is a derelict on the sea of the law, now that the Commerce Clause has been much more broadly construed, this makes these cases inapplicable to section 2(c). Commerce clause problems aside, however, section 2(c) is firmly grounded in the Property Clause (Art. IV, § 3, cl. 2) of the Constitution, and suffers no infirmities if it is construed to prohibit railroad affiliates from holding federal coal leases. See *United States* v. *Midwest Oil Co.*, 236 U.S. 459, 474 (1915); *United States* v. *Gratiot*, 39 U.S. (14 Pet.) 526, 538 (1840); see also *Kleppe* v. *New Mexico*, 426 U.S 529 (1976).

---

[9] *United States v. Elgin, J. & E. Ry.*, 298 U.S. 492 (1936), followed *Delaware & Hudson* while criticizing its holding.

In short, the Antitrust Division analysis casts reasonable doubt on the proposition that the Commodities Clause precedent would be applied judicially to support the "alter ego" test established in the 1976 and 1979 Interior opinions. It is, however, overly broad to say that a "review of major cases construing the Commodities Clause shows that they provide *no* foundation for interpreting section 2(c) to allow leasing to railroad affiliates." Antitrust Division Memorandum at p. 23 (italics added). Certainly the first Supreme Court cases were the only law available to the Congress that considered and enacted section 2(c) on the consequences of Congress not clearly listing corporate affiliates in a statutory prohibition.[5]

It is reasonable, however, to conclude that the Commodities Clause cases are dubious precedent and would be unlikely to compel any reviewing court to adopt a narrow reading of the prohibition in section 2(c). Under these circumstances, any judicial inquiry would return to the issues of intent and construction of section 2(c) discussed above.

THE CONSEQUENCES OF AMBIGUITY

Where a statute is susceptible to more than one reasonable construction, prior transactions permissible under one construction are not disturbed by changing, prospectively, to an alternate construction. This principle is generally applicable to administrative agencies, 1 Davis, *Administrative Law Treatise* § 5.09, at 350–52 (1958), and has been specifically applied by courts to changes in the construction of the Leasing Act and regulations implementing the Leasing Act. *E.g., Safarik* v. *Udall*, 304 F.2d 944, 948–49 (D.C. Cir.), *cert. denied*, 371 U.S. 901 (1962). See also *McDonald v. Watt*, 653 F.2d 1035 (5th Cir. 1981); *Runnells* v. *Andrus*, 484 F. Supp. 1234 (D. Utah 1980). As these cases amply illustrate, this principle has been judicially endorsed in the context of altered positions on public land laws or Interior regulations that are amenable to more than one construction. Interior's long-standing practice is to avoid upsetting settled expectations by applying retroactively new statutory constructions. *E.g., Timothy Sullivan*, 46 L.D. 110, 113 (1917); *Right-of-Way Across Tribal and Allotted Indian Lands* . . ., 58 I.D. 319 (1943); *Franco Western Oil*

---

[5] In addition to *Delaware & Hudson*, these cases include *United States* v. *Delaware, L. & W. R.R.*, 238 U.S. 516, 527 (1915); *United States* v. *Lehigh Valley R.R.*, 220 U.S. 257, 271–72 (1911).

Co., 65 I.D. 427 (1958), *affirmed sub nom; Safarik v. Udall, supra.*[6]

As the discussion above illustrates, section 2(c) is a provision reasonably subject to at least two readings. In such circumstances an agency is not bound to continue past policy indefinitely so long as the revised policy is consistent with the enabling statute, and prospective application of the revised policy may be implemented without affecting vested rights. *See American Trucking Associations, Inc. v. Atchison, Topeka & Santa Fe Ry. Co.*, 387 U.S. 397, 416 (1967). The interests of serving current program needs and current understanding of Congressional purposes in enacting the provision, and the important interest of promoting harmony between federal agencies, are sufficient justification for the application of this principle. I conclude that it is lawful to alter the Department's position on the construction of section 2(c), and it is reasonable to abandon the view that only companies operating common carrier railroads and their "alter egos" are subject to the leasing prohibition. I recommend that Interior take the position that railroad affiliates are not excluded from the prohibition in section 2(c) on holding federal coal leases. By so concluding, I do not conclude that the Antitrust Division's guidelines for the scope of the affiliate prohibition (Antitrust Division Memorandum at pp. 29–31) are the only alternate view of the scope of the prohibition. The preceding discussion amply supports the view that Congress had no clear intention to define the statutory phrase "company or corporation operating a common carrier railroad" in a particular and specific manner.

You may proceed to define Interior's policy and construction of the statutory phrase, that is, the scope of the affiliate prohibition either by rulemaking or by adjudication. *SEC v. Chenery Corp.*, 332 U.S.C 194 (1947).[7] Finally, I conclude that any change in the Interior Department's construction and implementation of this section is prospective, and does not disturb past transactions. Thus, leases issued, or lease transfers approved, under the old construction were lawful actions not made voidable by the change in agency construction of the statute.

WILLIAM H. COLDIRON
Solicitor

APPROVED:

JAMES G. WATT
Secretary

---

[6] In light of the manifest ambiguity in the meaning of section 2(c), and this policy, it is unnecessary to examine what authority or obligation the Department might have to void actions taken under an unambiguously erroneous construction of law. *Compare Enfield v. Kleppe*, 566 F.2d 1139, 1142 (10th Cir. 1977) *with McDade v. Morton*, 353 F. Supp. 1006, 1012 (D.D.C. 1973), *aff'd without opinion*, 494 F.2d 1156 (D.C. Cir. 1974). *McDade* approved the statutory construction adopted in Solicitor's Opinion M-36686, 74 I.D. 285, 290 (1967).

[7] The Department has the authority, in interpreting section 2(c) consistent with the public interest, to fashion guidelines flexible enough to allow "emergency" leasing (43 C.F.R. Subpart 3425) and lease modifications (43 C.F.R. Subpart 3432) to railroad affiliates currently holding federal coal leases in order to avoid bypass or waste of federal coal, in order to prevent supply disruption or premature mine closing, or otherwise to serve the public interest.

STATEMENT

OF

DAVID J. WALSH

SENIOR VICE PRESIDENT

SANTA FE MINING, INC.

Before the

COMMISSION ON FAIR MARKET VALUE POLICY

FOR FEDERAL COAL LEASING

Washington, D.C.

November 17, 1983

Santa Fe Mining, Inc. (SFM) appreciates this opportunity to present its views and data pertinent to your proceedings, especially in light of the comments presented at your Denver hearings on October 25 and 26 concerning the participation of mining affiliates of common carrier railroads in Federal coal development activities. I have been asked to convey the views of SFM and its affiliated companies in the coal mining and mineral lands and development business, including SF Coal Corporation, Santa Fe Pacific Railroad Company (SFPR), Hospah Coal Company and Pintada Coal Company (collectively, "Santa Fe"). These companies are involved in all aspects of coal development, from exploration to production:

- SFPR, Hospah, and Pintada are major lessors of coal, having separately developed and leased over 500 million tons of proven coal reserves for mining;
- SFM is the holder of Federal coal leases and it, Hospah, and Pintada hold rights to a number of New Mexico State coal leases;
- SFPR is processing an equal value, fee-for-fee coal exchange with the Bureau of Land Management (BLM) pursuant to Section 206 of the Federal Land Policy and Management Act of 1976 (FLPMA); and
- SFM and SF Coal have developed and SF Coal will soon be producing from the Lee Ranch

surface coal mine in the San Juan Basin of New Mexico, which mine has a Surface Mining Control and Reclamation Act (SMCRA) permit allowing production of up to five million tons per year of private and State-leased coal.

These coal and mining companies are all owned directly, or through SF Minerals Corporation, by Santa Fe Industries, Inc. Santa Fe Industries is the parent holding company of other subsidiaries engaged in natural resources development, including oil and gas, and of companies involved in timber and forest products, construction, real estate, and transportation (rail, truck, and pipeline). Perhaps the best known subsidiary is The Atchison, Topeka, and Santa Fe Railway Company.

SFM's corporate affiliation with Santa Fe Railway has been the pretext for certain of our coal industry competitors to oppose any involvement on our part in Federal coal leasing or exchanges of coal. We detail in this statement why we believe a truly competitive Federal coal leasing process must include all companies, including those affiliated with railroads, and how coal exchanges under FLPMA may be used to develop Federal coal tracts that will attract more and higher lease sale bids.

1. Opening Up the Federal Coal Leasing Process to Railroads and Their Affiliates Would Enhance-Not Impair-Competition

In a letter dated October 25, 1983, SPM responded to Chairman Linowes' request to assist this Commission's review of Federal coal leasing policies by demonstrating why repeal of Section 2(c) of the Mineral Leasing Act of 1920 would increase Federal lease sale revenues by enhancing competition for Federal coal. During this Commission's recent hearings in Denver, however, several of our coal industry competitors made broad assertions to the effect that participation of mining affiliates of railroads in Federal coal leasing would be detrimental to competition. Lacking in specifics, their argument is that companies such as Santa Fe with large landholdings are supposedly in a dominant position which will somehow enable them to control future coal leasing and marketing activities. We believe the facts of coal ownership in the West prove otherwise with respect to Santa Fe.

Santa Fe's demonstrated coal reserves constitute but three tenths of one percent of the total proven coal reserves in the western United States. (Energy Information Administration, U.S. Department of Energy, Demonstrated Reserve Base of Coal in the United States on January 1, 1980 (May 1982)).

In 1978 the Justice Department conducted a detailed case study on the state of competition in the Southwest coal market (in which San Juan Basin coal competes) and concluded generally that the Southwest coal market was "workably competitive" (at

A-50) and stated that Justice had "encountered no indication of anticompetitive behavior in this market" (at A-51). The Justice Department views the extent of uncommitted coal reserves as the best indicia of a coal company's potential to adversely affect competition in that market. (DOJ 1978 Report at 55-62). Santa Fe's existing reserves in the Southwest coal market do not begin to approach the 15 percent of total uncommitted reserves that the Justice Department uses as prima facie evidence of market dominance. (Id. at 87). Santa Fe's uncommitted reserves in the Southwest coal market at the time of Justice's 1978 study did not exceed one percent of total uncommitted coal reserves in that market.

Even when the focus is narrowed to the San Juan Basin, one of many coal basins making up the Southwest coal market, it is apparent that Santa Fe's companies are in no position to dominate coal leasing and productions.

The following table shows approximate in-place coal reserve ownership in the San Juan Basin (where almost all of Santa Fe's reserves are located) and includes both surface and underground-mineable coal:

OWNER	TOTAL TONNAGE (millions of tons)	TONNAGE LEASED TO OTHERS (millions of tons)	UNLEASED (millions of tons)
Federal Government	3668 1/	1068 2/	2600 3/
Indian Tribes	1956.2 4/	1900	66.2 5/
State of New Mexico 6/	130	120	10
Santa Fe 7/	804	503	301
TOTAL	6552	3591	2977.2

1. Includes only PRLA's, leases, and coal scheduled for lease in 1984.

2. Minerals Management Service (BLM), Farmington, New Mexico, November 1983 (oral communication).

3. San Juan River Regional Draft Coal EIS, 1983, (includes 1.4 billion tons of Federal coal contained in 26 PLRA's) (p. xiv).

4. Minerals Management Service (BLM), Farmington, New Mexico, November 1983 (oral communication).

5. This number represents surface-mineable coal only. "Strippable Low Sulfur Coal Resources of the San Juan Basin in New Mexico and Colorado" J.W. Shomaker, E.C. Beaumont, and F.E. Kottlowski; Memoir 25, New Mexico Bureau of Mines and Mineral Resources, 1971 (identifies 40 million tons owned by the Southern Ute Tribe (p. 104) and 16.2 million tons owned largely by the Zuni Tribe (p. 80)). Another 10 million tons are owned by the Ute Mountain Ute Tribe. (Draft EIS, Ute Mountain Ute Proposed Strip Coal Mining, San Juan County, New Mexico, BIA Albuquerque area office, September 1980 (p. 51)).

6. Estimate, New Mexico State Land Office, November 1983 (oral communication).

7. Includes reserves owned by SFPR, Hospah and Pintada. Santa Fe Industries, Inc., 1982 Form 10-K (Report to Securities and Exchange Commission, dated March 28, 1983).

As this table shows, 504 million tons of Santa Fe's demonstrated reserves, or 63%, are leased to other mining companies. These same companies in turn control over 500 million tons of in-place Federal and Indian coal in New Mexico alone through leases or PRLA's. (Minerals Management Service, (BLM), Farmington, New Mexico, November 1983 (oral communication). Santa Fe's uncommitted reserves account for only 10% of the total uncommitted reserves in the San Juan Basin. As the table also shows, the unleased Federal coal alone in the San Juan Basin is 1-1/2 times greater than Santa Fe's total identified coal reserves, and four times greater than Santa Fe's unleased coal reserves. In addition, of the unleased coal owned by Santa Fe companies 52.8 million tons are committed to long term coal supply agreements, which reduces their percentage of uncommitted coal in the San Juan Basin alone to only 8 percent.

Clearly this minority position in western coal ownership cannot be construed by any objective reviewer to show Santa Fe to possess a monopoly status with respect to future coal development in the San Juan Basin or elsewhere.

Nor would allowing Santa Fe to lease Federal coal permit it to develop a monopoly position. The lion's share of unleased low suflur and low stripping ratio Federal coal is located in the Powder River Basin, an area outside of any railroad checkerboard lands and a region in which SFM holds no coal rights. Most of our coal reserves are already leased to others or committed by long term contracts. Further, Federal law restricts to 46,080 acres in any state and 100,000 acres overall on which any company (including affiliates or companies under common control) may hold or control Federal coal leases, applications, or bids. 30 U.S.C. § 184(a). An additional safeguard is the antitrust review procedure of Section 15 of the Federal Coal Leasing Amendments Act (FCLAA) which requires the Attorney General to determine whether the proposed acquisition of a Federal lease would "create or maintain a situation inconsistent with the antitrust laws." 30 U.S.C. § 184(1). In conducting this review, the Attorney General takes into consideration the full range of the antitrust statutes and, in addition, applies the incipiency standard of section 7 of the Clayton Act to lease sales. (Department of Justice, Competition in the Coal Industry (May 1978) (pp. 6-7)). The goal of section 7 is to preserve competitive market behavior and requires a finding not that competition has been or will be actually lessened, but only that competition may be lessened. Id. at 7-9. Prospective review of leases by the Attorney General, in the words of Rep. Mink, the Chairman of the Subcommittee on Mines and Mining of the House Committee on Interior and Insular Affairs, from which the FCLLA emanated:

> "should help assure that large corporations or holding companies do not monopolize the desirable Federal leases to the detriment of smaller business entities and increased competition in the coal industry." 122 Cong. Rec. H. 134 (January 21, 1976).

In their continuing attempt to insulate themselves from competition from Santa Fe and other mining companies affiliated with railroads, our competitors at the Denver hearing engaged in some revisionist history making. No railroad acquired grant lands "free", as our competitors charged. The land grant which SFPR holds was originally earned by the Atlantic and Pacific Railroad Company (A&P), a company completely unrelated to Santa Fe Railway or any Santa Fe company. To help pay for the cost of construction of a railroad and telegraph line from Missouri to the Pacific, the A&P was offered the right to earn a land grant from the United States. Following construction, the A&P went into bankruptcy and, at a subsequent foreclosure sale, SFPR bought the properties and obtained the rights of the A&P in consideration of assuming the A&P outstanding debt. In 1902, SFPR deeded the railroad and right of way to Santa Fe Railway and retained ownership of the earned grant lands.

The A&P did not receive those lands "free"; it went bankrupt paying the price for those lands--the substantial risk and hardship assumed in building a transcontinental railroad in the 1860's. The A&P's grant specifically stated that no Federal funds were to be used in construction of the railroad. The A&P right to receive grant lands was conditioned on its actual completion of each stretch of 25 consecutive miles of the railroad and telegraph line and upon completion it received only the grant lands coterminous with the completed section. Another condition of the grant required the railroad to carry government freight and passengers for half the rate charged to others and to carry mail at a reduced rate. The value of the land grant was repaid many times over by these freight rate discounts. (W. Greever, Arid Domain (1954)).

Our competitors complain that SFPR would not pay a royalty to the United States on coal it might mine on land grant properties because it owns them. However, we fail to see any inequity in this situation. No other owners of fee lands, including our competitors, pay a royalty on coal developed on their own lands.

2. SFPR's McKinley County Exchange is an Example of an Effective Land Management Tool to Enhance Competition for Federal Coal

Land exchanges offer industry and the Federal Government alike an important land management mechanism in areas where Federal holdings are intermingled with private holdings.

Santa Fe's involvement with exchanges of land with the Federal Government goes back to its beginning years in the late 1890's at which time the Government was formulating a policy of setting aside permanent forest reservations. One of the first formal exchanges was completed in 1902 when President Theodore Roosevelt signed an agreement involving the exchange of over 500,000 acres of SFPR lands in the vicinity of the San Francisco Mountains north of Flagstaff, Arizona, for approximately 150,000 acres of in-lieu lands.

This exchange was followed by many others, the most notable of which included an exchange in 1903 in which SFPR surrendered 375,000 acres of land in the Grand Canyon Reserve for in-lieu Federal acreage of approximately the same amount. In 1929 a similar exchange was culminated with the National Park Service in connection with rounding out the Government's holdings in the Petrified Forest National Park area. A similar exchange was made in 1929, in which SFPR surrendered over 6,000 acres to help in the establishment of the Chaco Canyon National Monument. More recently, in the early part of 1978, SFPR attempted to work out an exchange with both the Park Service and the BLM involving 75,000 acres of mineral rights which SFPR now holds in the Lake Mead National Recreation Area (64,000 acres) and Grand Canyon National Park (11,000 acres). It fell apart largely because of the complexities of working with two separate government agencies, one of which would receive SFPR lands while the other would be relinquishing lands it managed.

The genesis of the present McKinley County Exchange was the creation in 1980 of the Chaco Culture National Historic Park, which expanded the boundaries of Chaco Canyon National Monument to include lands in which SFPR holds reserved mineral rights. The legislation creating this new Park permits SFPR to exchange its mineral lands in the Park for Federal mineral lands located elsewhere. SFPR initially proposed to exchange its lands for Federal coal lands now part of the McKinley County Exchange located within the Lee Ranch Mine area and interspersed with coal owned by SFPR. Because of the mineral valuation difficulties associated with minerals located beneath prehistorically and culturally significant lands, SFPR later offered its coal in parts of the Lee Ranch area in return for Federal coal in the area.

The resulting coal-for-coal exchange will be, as required by section 206 of FLPMA, an equal value exchange based on data supplied by Santa Fe and on data produced by the BLM's Economic Evaluation Unit in New Mexico (whose activities you heard described last month in Denver). In connection with the Exchange and our nomination of tracts for Federal leasing, Santa Fe provided BLM with substantial proprietary drilling information regarding coal quality and quantity on our fee and State-leased lands, environmental data, and proof of surface owners' consent under SMCRA. As a result of this information and our open participation with the BLM, the public, other mining companies, and the San Juan River Regional Coal Team in the Federal coal nomination and tract delineation process, the four tracts which Santa Fe had nominated for Federal leasing were rated as having high to medium potential for development and leasing and are included within the preferred alternative under the Draft Environmental Impact Statement for the San Juan Basin sale. The extensive proprietary data Santa Fe supplied will be available to the public once the tracts are made available for lease, whether or not the McKinley County Exchange is approved. This completely refutes the allegations sometimes made by our competitors that owners of land grant properties could possess an unfair advantage over others in checkerboard areas because of their unique knowledge of the coal potential of the areas gained by exploratory work on their own lands.

The McKinley County Exchange will be an important supplement to Federal leasing. BLM will gain two solid blocks of coal with high potential for leasing. SFPR will be able to consolidate coal within and adjoining its mine permit area into a unified mining unit.

The two Federal tracts to be created by the Exchange are expected to offer high interest to prospective bidders for the following reasons:

- While the coal tonnages to be exchanged are approximately equal (the BLM will receive about 98 million tons and SFPR will receive about 101 million tons), the two Federal tracts will have a stripping ratio of 7.9:1, while the private tract will have a ratio of 9.3:1. The lower stripping ratio (the advantages of which were pointed out by the coal industry panel at your Denver hearings) on the Federal tracts should be especially attractive to bidders;
- The Federal tracts will be located close to rail transportation;
- The coal offered to the Federal Government by SFPR constitutes coal reserves proven by extensive drilling, the results of which will be available to all bidders. SFPR in turn will receive coal resources estimated

on the basis of relatively sparse drilling on Federal lands;

* The exchange would allow increased conservation of the total coal resource by permitting the mining of unified logical mining units in a more efficient and environmentally sensible manner;

* The exchange will make available Federal coal in an area remarkably free of the environmental and land use conflicts affecting other Federal lease tracts, leases, and PRLA's in the San Juan Basin. For instance, since the Federal tracts are on private land (with surface owners' consent), no Navajo Indians would have to be relocated prior to mining. Nor would there be conflicts with Chaco Culture National Historical Park or its outlying ruins, BLM Wilderness Study Areas, or other areas significant for their archeological or paleontological resources.

* The exchange has received widespread public support from such diverse parties as:

The Sierra Club
Pro-energy advocacy groups
U.S. Fish and Wildlife Service
New Mexico Commissioner of Public Lands
New Mexico Energy & Minerals Department
New Mexico Department of Commerce & Industry

New Mexico Department of Natural Resources
Local governments
Concerned citizens

These groups all support this exchange because it makes sense as intelligent land management. It will result in the production of needed fuel from an area virtually free of environmental and land use conflicts. It will also generate employment in a high unemployment region of New Mexico.

Predictably, this exchange has not received support from companies with whom Santa Fe will compete and which operate existing mines or which hold PRLA's. Some of these companies, individually and through such organizations as the National Coal Association and the Mining and Reclamation Council of America, have expressed their opposition to this exchange on the grounds that it is "anticompetitive" and in violation of the "spirit" of Section 2(c) of the Mineral Leasing Act of 1920.

While the McKinley County Exchange will create a more efficient mining unit at the Lee Ranch Mine and therefore be procompetitive, it also will permit other coal producers to have the opportunity to enhance their competitive positions by bidding on larger tracts of blocked up Federal coal, with the result that competition will be further stimulated. This result could only be called "anticompetitive" in the distorted sense that these companies use that term; i.e., to mean any action that would mean increased competition with them. This is the kind of economic protectionism that the law tries to prevent, not to promote.

Section 2(c) plainly has no application to FLPMA Section 206 exchanges. In enacting Section 2(c), Congress simply restricted the leasing of Federal coal to railroad companies; it did not restrict any other method of transferring Federal coal to mining companies indirectly affiliated with the railroads.

I urge this Commission to recommend the use of equal value coal-for-coal exchanges under Section 206 of FLPMA in order to promote competition through the assembly of more efficient mining units. However, exchanges are but one way to promote competition for Federal coal. FLPMA exchanges are restricted to the trading of lands within one state. Exchanges may often be costly and time consuming, and may present difficulties associated with valuation where inadequate data is available. The long overdue repeal of Section 2(c) would allow Santa Fe to compete for Federal coal in New Mexico and elsewhere.

Conclusion

In conclusion, Santa Fe is not in a dominant position with respect to the control of coal leasing and production in the San Juan Basin. We own less than 8 percent of the proven uncommitted surface mineable coal reserves in the San Juan Basin, and over 63 percent of that is leased to other coal producers who in turn control over 500 million tons of Federal, state and Indian coal.

We believe that the Federal Government should lease substantial reserves under flexible terms which encourage coal development in order that normal supply and demand forces can freely work to set a fair market price. Such a process must be open to all companies; in this respect, Section 2(c) is clearly an outdated and unneeded barrier to competition. Over the years this provision has artificially restricted the number of firms competing for Federal coal and has likewise limited the amount of land available for coal production.

Stimulating competition for Federal coal by opening up the process to all companies is in the public interest; protecting the entrenched positions of existing coal producers by excluding competition clearly is not.

STATEMENT
OF
JOHN A. GRYGIEL
ASSISTANT VICE PRESIDENT-PRICING
THE ATCHISON, TOPEKA AND SANTA FE RAILWAY COMPANY

Before the

COMMISSION ON FAIR MARKET VALUE POLICY
FOR FEDERAL COAL LEASING

Washington, D.C.
November 17, 1983

I am John A. Grygiel, Assistant Vice President-Pricing of The Atchison, Topeka and Santa Fe Railway Company. I received a Bachelor of Science Degree from Rutgers University in 1949 and an M.B.A. Degree from the University of Chicago in 1950. I have over 30 years experience in railroad marketing.

My present responsibilities embrace the pricing of rail transportation on the Santa Fe system. In particular, I am continually involved in reviewing the factors considered in pricing present and potential coal movements.

My statement addresses the overall competitive environment for the movement of coal in the western United States and in particular the absence of monopoly by any railroad in the southwest, Santa Fe's position in that marketplace, and the inability of a carrier such as Santa Fe to discriminate in favor of or against any particular sources of coal supply such as railroad affiliated coal producers.

There is strong competition today for the movement of western coal to electric utilities and other users. Railroads compete against other railroads and against other modes of transportation for western coal movements, and western coal sources compete against other types of fuel and against each other for coal supply contracts. This product, source, intermodal, and intramodal competition effectively preclude any western railroad from acquiring or exercising monopoly power in the transportation of coal.

In analyzing competition for the transportation of coal it is helpful to focus on the decisionmaking process by which utilities, consumers of about 80 percent of all coal produced in the United States, evaluate coal supply and coal transportation alternatives. My statement sets forth in detail the flexibility utilities have in that process.

Source or geographic competition probably is the most important type of competition in the transportation of western coal. Coal producers throughout the western United States compete vigorously against each other.

Extensive intermodal competition also exists for transportation of western coal. Common carrier railroads, privately-owned railroads, barges, trucks, mine-mouth generating plants, and slurry pipelines all are factors which a utility may consider in deciding how to transport coal to its generating facilities.

Competition among railroads is another competitive force which affects a utility's selection of the source and quantity of coal which it will purchase. Burlington Northern, Union Pacific/Missouri Pacific, Denver, Rio Grande and Western, Chicago and North Western, and Santa Fe all are major coal carriers in the western United States and all compete against each other in attempting to persuade a utility to route coal over their rail lines. Since the various railroads operate to some extent in different service territories, rail intramodal competition often involves source competition as well.

Source, intramodal, intermodal, and product competition combine to influence a utility's decision to obtain fuel for its planned and existing generating plants. My submitted statement summarizes actual cases involving utilities' decisions to buy coal for their generating plants, and how these various kinds of competition prevent any coal producer or coal carrier from obtaining a monopoly over the production and transportation of coal.

Central Illinois Lighting Compay in recent years has purchased coal from three separate sources, each involving different rail carriers and in one case also involving a water carrier. The involved carriers and sources are specified in my written statement.

Movements to the electric generating facilities of Northern Indiana Public Service Company at Gary and Wheatfield, Indiana, also demonstrate how source competition and intramodal competition prevent a railroad from securing monopoly power over the transportation of coal. You also have these details in my complete statement.

Source and intramodal competition also have been influential in recently initiated coal movements to Southwestern Public Service Company's generating facility at Mill, Texas, and in coal movements scheduled to begin in 1984 to the Plains Electric power plant near Prewitt, New Mexico.

Another example of the intense competition for the movement of coal from western mines is the recent announcement of a new contract for the movement of coal by CNW-UP-MP from Wyoming to Arkansas Power and Light's facilities in Arkansas instead of Burlington Northern service as origin carrier.

Therefore, it is clear that no railroad has a "monopoly" over transportation of western coal. Railroads face vigorous competition from other railroads, other modes of transportation, and from a utility's ability to choose from a number of different sources of coal or to use fuels other than coal. These competitive alternatives effectively restrain railroads from exercising market power in the transportation of western coal. For these reasons, the Justice Department concluded in its 1980 Report that no railroad in the Southwest has market power over the transportation of coal. Without possessing any market power over coal transportation, it is impossible for any railroad transporting Southwestern coal to have a monopoly over coal transportation.

There is a basic concern that a railroad has the power to unfairly discriminate in favor of rail affiliate coal producers at the expense of other coal producers. This concern is fundamentally unwarranted. No western railroad has a monopoly over coal transportation or possesses sufficient monopoly power to be in a position to manipulate its coal rate pricing policies in such a fashion as to profit from favoring certain mines over others.

One strategy to profit from a monopoly over coal transportation would lead railroads to limit coal production from some mines at the expense of others. It would be impossible in practice for a western railroad to attempt to gain monopoly profits by limiting a coal production because no western railroad or railroad affiliate is capable of producing enough coal to affect coal prices by restricting coal supply. Santa Fe's affiliates own or lease 810 million tons of coal but these reserves constitute three tenths of one percent of the total proven coal reserves in the western United States. Restricting coal production would reduce coal traffic volumes, which in turn would reduce the railroad's profits.

A strategy of rate discrimination in favor of affiliated mines would similarly not be feasible. Santa Fe does not serve any affiliated coal producers. It has the potential to provide service to affiliated mines in the San Juan Basin and that, for the foreseeable future, is the only affiliated production source it can serve. Santa Fe also serves other coal producers in New Mexico in direct service and has participated in movements from mines served by other railroads in Colorado, Montana, Utah and Wyoming. If Santa Fe attempts to discriminate in favor of the production from the San Juan Basin and artificially inflates the pricing of coal transportation for other movements in which it could participate, this would simply have the effect of eliminating it as a competitor for the bulk of potential movements in which it could participate.

The coal producers' argument that Section 2(c) of the Mineral Leasing Act should be allowed to continue to restrict competition in coal production markets because the Staggers Act permits the marketplace to function, within limits, to set coal transportation rates is illogical. The removal of undue government regulation in one area certainly is no reason for continuing undue government regulation in another area. Congressional policy that railroads should be free to compete for coal traffic on the basis of price, with the limitation that no rail rate for coal can be unreasonably high, also should apply to coal production markets, in which railroads should be permitted to begin to compete effectively by leasing federal coal lands.

Finally, any railroad which the Interstate Commerce Commission finds to be market dominant in coal transportation is barred from charging an unreasonably high rate for transporting the coal. Moreover, the ICC would regard the rail rates charged from a rail affiliate's coal mine as a measure of maximum reasonable rates which could be charged by that railroad from other non-affiliated coal mines.

All of these remedies available to coal producers demonstrate that Section 2(c) is completely unnecessary to protect against potential anticompetitive actions by railroads or rail affiliates acquiring federal coal leases. These remedies are the reason why ICC Chairman Reese Taylor informed Congress on September 30, 1981, that there is no need for Section 2(c) to protect against anticompetitive actions by railroads or rail affiliates. His analysis still is true today.

I agree with the ICC's view in this area, and I appreciate the opportunity to appear before you today.

Remarks Of

William F. Baxter
Assistant Attorney General
Antitrust Division

Before the

Commission on Fair Market Value
Policy for Federal Coal Leasing

Concerning

Federal Coal Leasing Policies

November 17, 1983

Mr. Chairman and Members of the Commission:

I am pleased to have this opportunity to convey the views of the Department of Justice ("Department") on certain issues relating to federal coal leasing policies. First, I wish to point out that the Department is keenly interested in ensuring that federal policies generally do not stifle competition or produce inefficiencies. The antitrust laws are a broad "consumer welfare prescription," Reiter v. Sonotone Corp., 442 U.S. 330, 343 (1979), and enforcing them requires that the Department carefully evaluate the effects on economic welfare of the various business practices that come under its jurisdiction.

With respect to coal leasing in particular, the Department has been extensively involved in the formulation of federal policy at least since the passage of the Federal Coal Leasing Amendments Act of 1976. The Department has devoted a great deal of time and resources to an ongoing examination of competition in the coal industry, pursuant to Section 8 of that Act. As we have stated on previous occasions, our analysis has persuaded us that the two statutory provisions you have asked me to address today--the diligent development requirements of 30 U.S.C. § 201(a)(2) and the prohibitions on leasing to any common carrier railroad or its affiliate contained in 30 U.S.C. § 202--are inimical to the efficient development and operation of the nation's coal markets.

Section 2(c) of the Mineral Lands Leasing Act

Section 2(c) of the Mineral Lands Leasing Act, 30 U.S.C. § 202, prohibits the issuance of federal coal leases to any "company or corporation operating a common carrier railroad . . . except for its own use . . . for railroad purposes . . . ." The precise scope of the prohibition on leasing to railroads contained in section 2(c) has never been judicially determined. However, the Department has interpreted this provision to mean that no federal lease may be issued to a common carrier railroad or to any company controlling, controlled by, or under common control with, a common carrier railroad or to a joint venture in which such a railroad or company is a major participant.

While there have historically been some differences of opinion as to the precise extent to which section 2(c) prohibits the leasing of federal coal to railroads, the real issue is whether the broad existing statutory prohibition of such leasing is appropriate. For the reasons I will describe, the Department believes that the current provision is not appropriate and should be repealed. Statutory or regulatory restraints on free market forces in coal--as in other markets--should be no broader than necessary to achieve important public goals.

Three years ago, the Department completed an analysis of whether and when the issuance of federal coal leases to common carrier railroads could be anticompetitive. 1/ We concluded that leasing federal coal reserves to common carrier railroads could have anticompetitive effects only under certain circumstances. If a railroad with market power over the transportation of coal in particular markets also owned substantial coal reserves in those markets, it could find it profitable to drive up the price of coal by withholding coal transportation services. Monopoly profits that might otherwise be unattainable because of ICC regulation of transportation rates might thus be collected through coal operations. While the railroad would forego some transportation revenues, and would have to share with other coal owners the monopoly profits in coal generated by the restriction of transportation services, it might still find it profitable to restrict coal transportation services. Whether and to what extent the

---

1/ Competition in the Coal Industry, Report of the U.S. Department of Justice Pursuant to Section 8 of the Coal Leasing Amendments Act of 1976 for Fiscal Year 1979 (November 1980).

railroad would find it profitable to restrict the supply of coal transportation services would depend in part on the railroad's share of the coal in the relevant market. Of course, a railroad that owned no coal would have no incentive to restrict coal transportation services.

Anticompetitive effects in coal markets of the kind described above are possible, however, only if: (1) a railroad has market power in the transportation of coal; (2) the railroad's ability to obtain monopoly rates for such transportation is constrained by ICC rate regulation; and (3) the railroad is able to restrict transportation services notwithstanding ICC regulation.

Determining whether the second and third of these conditions exist or are likely to exist in the future is complex and difficult. These matters were discussed in detail in the 1980 Coal Report. That Report concluded that these conditions probably did exist; however, the question is not free from doubt, and depends on the nature and effectiveness of

ICC regulation. 2/ The answer to the first inquiry, however--that is, whether a railroad has market power over the transportation of coal--may differ from railroad to railroad. If, as we believe to be the case, railroads in general do not have such power, a blanket leasing prohibition such as section 2(c) is not appropriate.

Absent market power in the transportation of coal, a railroad will be unable profitably to withhold coal transportation services. Coal shippers will simply use other means of coal transportation. The railroad will lose transportation revenues without restricting supply sufficiently to cause an offsetting increase in the price of coal. As a matter of empirical fact, the Department concluded that only the Burlington Northern had sufficient market power and thus the possible incentive to act anticompetitively if federal coal

---

2/ ICC regulation of coal transportation rates is in a state of flux and the Department has not followed recent developments sufficiently closely to know whether regulation still effectively constrains rail rates for coal. It is possible that the rate increases that have followed the passage of the Staggers Act were sufficient to eliminate regulation as an effective constraint on rates, at least insofar as there may no longer be an incentive for a coal-holding railroad with market power to restrict the supply of transportation services to drive up the price of coal.

leases were issued to it. 3/ But even in the case of the Burlington Northern, not every coal lease issuance would necessarily create competitive problems.

Because the issuance of federal coal leases to most railroads would not raise serious competitive concerns, we see no reason to continue to prohibit railroads in general from acquiring federal coal leases. As for those few situations in which anticompetitive effects may be possible, there is already a mechanism in place that adequately protects competition.

Under section 15 of the Federal Coal Leasing Amendments Act of 1976 ("FCLAA"), the Secretary of the Interior must consult with the Attorney General prior to each issuance, readjustment or renewal of a federal coal lease. The Attorney General advises the Secretary whether the particular lease under review would create or maintain a situation inconsistent with the antitrust laws. Where it is reasonably likely that a proposed

---

3/ The Department has not undertaken any study of the effect, if any, of the anticipated entry of the Chicago and NorthWestern Transportation Company into the rail transportation of coal out of the Powder River Basin.

lease would create the kind of competitive problem I have described, we would advise the Secretary not to issue it. 4/

Section 2(c) is not only unnecessary, it may itself produce anticompetitive effects by restricting the ability of railroads to compete effectively in coal markets and by interfering with the efficient development of substantial coal deposits. Railroad coal is interspersed in many areas with federal coal in such a manner that neither the railroad coal nor the federal coal can be efficiently mined. Section 2(c) is an obstacle to the development of these "checkerboard" lands, because it tends to impede the railroad's ability to acquire the coal necessary to form logical mining units. Others may develop these lands only by dealing with both railroads and the Federal Government; hence, for them, transaction costs may be higher than for the railroads. Section 2(c) may require that these transaction costs be incurred, thus increasing the cost of coal to users.

If railroads were permitted to bid on the federal coal interspersed with their own, it is likely that a railroad

---

4/ Upon receiving such advice, the Secretary would then be unable to issue the lease unless he held a hearing and specifically found: (1) that the lease issuance is necessary to effectuate the purposes of the FCLAA; (2) that it is in the public interest; and (3) that there are no reasonable alternatives consistent with the FCLAA, the public interest and the antitrust laws.

owning a tract adjoining a federal lease would bid more for a federal lease that would give it a logical mining unit than its competitors would bid for the same tract. Competitors might be unwilling to bid as much as the railroad because they would be bidding only on the possibility that they could economically mine the leased coal. In these circumstances, the railroad's ability to bid higher reflects a real social resource saving which should be achieved and passed on to users.

Of course, one can always make an argument against diversification by a regulated monopoly into adjacent, unregulated activities. Such diversification complicates the process of regulation and may introduce distortions into those adjacent markets. But the strength of this argument depends upon the degree of economic power of the regulated entity and the absolute size of its regulated and proposed unregulated activities. Neither of those factors is of sufficient magnitude to justify a sweeping prohibition on railroad participation in coal mining activities.

In short, we believe that the leasing prohibition contained in section 2(c) is neither necessary nor appropriate. Indeed, section 2(c) may have anticompetitive effects in the nation's coal markets by preventing railroads from becoming vigorous competitors in the coal industry and by deterring the efficient development of coal reserves. Accordingly, we urge the Commission to recommend its repeal.

Diligent Development Requirements

Section 3, along with other provisions of the FCLAA, amended pre-existing requirements of the Mineral Lands Leasing Act concerning the diligent development of federal coal leases. The new provisions were intended by Congress to "discourage speculative holding" by, inter alia, prohibiting the issuance of federal coal leases to any person that has held a federal coal lease for 10 years without commercially developing it and requiring termination of any lease that is not in commercial production at the end of 10 years.

The effects of the FCLAA provisions are: (1) to require that all federal coal leases issued after the passage of the FCLAA be "producing in commercial quantities" within ten years of the date of issuance; and, (2) indirectly to subject leases issued prior to the passage of the FCLAA to similar requirements, because any person that holds a pre-FCLAA lease that is not in production by 1986 is precluded from obtaining additional leases.

The Department believes that these and related provisions are premised on a mistaken belief that speculation in coal reserves is undesirable. In fact, coal companies serve a useful role by holding parcels of undeveloped reserves while searching for the utilities for which those parcels are the most economical sources of coal. But the ten-year development requirement may not permit companies to hold the reserves until they can find the best match of coal deposit and customer, thus significantly impairing the efficiency of the market. Given the complexity of matching coal deposits with customers, even a minimum holding time substantially in excess of ten years may impose signficant inefficiencies.

Perhaps equally important to the Commission, these provisions may reduce the sums that coal companies are willing to bid for many coal leases. For example, if there were only one chance in five that the ten-year development requirement could be met, then, since firms are risk-averse, no coal company would be willing to bid even as much as one-fifth of the value that the tract would have if it were certain that it would meet the requirement. In other words, these provisions increase the risk inherent in buying federal coal leases that may not be developed during the statutory holding period. In such cases, they interfere with the efficient functioning of coal markets and reduce the value of federal coal leases.

Accordingly, we urge the Commission to review not only section 3, but all provisions in existing coal leasing law relating to "diligent development" or "continued operation" of federal coal leases.

Mr. Chairman, that concludes my prepared remarks. I would be happy to respond to any questions that you or any other members of the Commission may have.

UTAH INTERNATIONAL INC.
550 CALIFORNIA STREET · SAN FRANCISCO, CALIFORNIA 94104
CABLE ADDRESS: UTAHINTL · (415) 981-1515

January 6, 1986

The Honorable John Warner
Chairman, Subcommittee on Natural Resources
Development and Production
United States Senate
Washington, D. C. 20510

Re: Mineral Lands Leasing Act Amendments

Dear Senator Warner:

Herewith are the responses of Utah International Inc. to the questions submitted to us under your letter of November 19, 1985.

We appreciate the opportunity to contribute to the efforts to amend the Mineral Lands Leasing Act and the consideration of our views.

Sincerely,

T. R. Winterer
Senior Vice President

Attachments

ANSWERS TO QUESTIONS UNDER HEADING

"COAL LEASING, NOVEMBER 8, 1985,

"Questions for Coal Company Panelists"

(Questions from Senator Ford)

Question #1. Senator McClure's Section 2(c) amendments, while a step in the right direction, are not adequate to prevent the development of a competitive imbalance in favor of the coal owning railroad. This imbalance would apply both to 1) bidding on the federal coal lease and 2) selling the coal produced from the lease. A coal owning railroad, by reason of its control of the facilities for transportation of coal which would be produced from a particular federal lease to be put up for bid, would or could know in advance of any bid, the tranportation costs which would obtain for deliveries to the likely markets and would have, therefore, a distinct competitive advantage in any bidding on a tract of coal within the railroad's service area. In addition, once having secured the federal lease and having entered the coal sales market its control of transportation costs and facilities would provide an advantage in sales to customers; and this would be true regardless of whether competing coal suppliers were inside or outside the railroad service area, as long as they were competing for the same coal consumer.

The leasing mechanism proposed in Senator McClure's Amendment No. 801 to solve the railroad's advantage in bidding on leases would take effect only if the Secretary of the Interior finds that "competition for the federal lease would be substantially enhanced thereby", a rather subjective determination. Further, Amendment No. 801 provides that if the federal reserves at issue constitute less than 35% of the total reserves in the potential mining unit, the special leasing mechanism does not apply, nor would it apply in a case of a joint venture which would own or control the federal lease when the railroad or affiliated company has less than a 30% interest in the joint venture. These are substantial exceptions.

The mechanism proposed in Amendment 801 to cure the transportation advantage is not an acceptable solution. It offers no real method for the non-railroad coal supplier to prevent the anti-competitive activity of the railroad until after the coal consumer has committed itself to the railroad and the competition is over. Furthermore, it does not protect a coal mine in one railroad's service area from the anti-competitive advantage of another railroad's coal affiliate.

The general thrust of Amendment No. 801 may be an acceptable beginning to finding a solution to the 2(c) problem, provided that railroads should not be permitted to bid for leases in their own checkerboard area and provided further that some mechanism is developed to eliminate to the maximum possible extent the transportation advantage that a coal-owning railroad or affiliate would have by reason of its control of the mode of transportation of its coal. It must be realized that Section 2(c) is more a transportation problem than a leasing problem and should be considered separately from the other proposed amendments to the leasing Act. We refer to Mr. Holsten's written testimony for an elaboration of our concerns.

Q.2. See answer to Question 1. One possible way of eliminating the railroad transportation advantage would be to require railroads to, in advance of any lease sale, publish tariffs or otherwise publish the terms and conditions upon which they would transport coal from the area of the proposed lease sale to various geographic markets, and require that the railroad transport all coal from the lease area upon such terms and conditions. However, as previously stated any modification of Section 2(c) is intimately connected to basic transportation questions.

Q.3. While it is true that in instances where there is head to head competition for the rail transportation of coal a railroad coal company affiliate would not have the same advantage over other non-railroad affiliated coal producers, it is nonetheless true that the railroad coal company affiliate would have significant advantages. For example, the railroad could subsidize the transportation of coal in order to insure that its coal would be produced and marketed. Moreover, the railroad coal company could very well receive favorable treatment from the railroad in terms of such things as car allocation and switching which could confer a distinct advantage on the railroad coal company affiliate over non-railroad affiliated coal producers. Moreover, even in areas where there is alternative rail transportation, the railroad coal company affiliate would have a better knowledge of transportation costs than a non-railroad affiliated coal producer which would give it a distinct advantage in any competitive situation.

Q.4. Yes, we would be opposed. See answer to Question 3.

ANSWERS TO QUESTIONS FOR PANEL I
SUBMITTED BY SENATOR JOHNSTON

Question 1. Whether or not Utah International Inc. would relinquish or assign noncomplying leases (assuming that Congress does not amend Section 2(a)(2)(A)) would obviously depend first upon the need to qualify to participate in a future federal mineral lease program. The preferred course of action would no doubt be to seek a purchase and sale opportunity for noncomplying leases - that would involve an assignment of the same. Certainly Utah would consider relinquishing noncomplying leases that were of slight value if they could not otherwise be disposed of on favorable terms and to do so would be necessary to qualify Utah for further leasing opportunities. Certainly Utah would not commence production on noncomplying leases merely to qualify Utah for further leasing opportunities. Existing federal coal leases would be produced only if it made economic sense to do so.

Q.2. The mandatory production requirements do not make good economic sense in any context. Ways should be sought to eliminate the effects of the mandatory production requirements rather than to increase their application. Accordingly, assignees of noncomplying leases should not be subject to the same production requirements that are applicable under present law to the assignors.

1/...

Q.3. It is difficult to fix a time deadline for bringing each federal coal lease into production, assuming that is required to satisfy "diligent development" requirements. Utah International Inc. has owned potentially commercial mining units which include several federal coal leases for 20 years or more. These units have been the subject of substantial development work at significant cost, as well as substantial marketing efforts. However, notwithstanding the work and efforts, a market for the coal has not yet been found. It may be another 10 years or more before these mining units can be brought into production. If diligent development was defined to mean the expenditure of monies in development work or payment of some minimum royalty, then it may be appropriate to require diligent development commencing some period of time, say 10 years, following readjustment (of pre-1976 leases) or following issuance (for new leases).

Q.4. Legislative efforts to cure the Section 2(a)(2)(A) problem have been underway for a long time. Companies which have taken steps to avoid the proscription of that section have done so for their own reasons, and with knowledge of the possibility of legislative relief. Legislative relief cannot be viewed as working a "penalty" on those companies who have gotten themselves into a position whereby the Section 2(a)2(A) proscription does not apply. Failure to eliminate the problem penalizes those companies who are not in a position to avoid that proscription.

Q.5. The turnback option contained in S.372 is one option that could be made available to existing coal lessees as a means of qualifying for future federal coal leases. It is not and should not be, however, the only option. The turnback provision based on a coal - region factor, seems somewhat arbitrary, inasmuch as even within coal regions, there is much variation among coal deposits.

Q.6. Permitting an existing coal lessee to acquire new federal leases upon the payment of a higher rent under existing coal leases is another option that could be made available to existing coal lessees as a means of qualifying for new federal leases. That option, however, should not be afforded to only lessees holding one or two noncomplying leases but should be made available to all existing federal coal lessees. It is quite common for a potential mining unit to contain several federal coal leases, not just one or two.

Q.7. No. An election to conform existing federal coal leases to then current regulatory requirements was offered existing federal coal leases in 1982 and those who thought it advantageous to do so caused their existing federal coal leases to be conformed to then current requirements. Federal coal leases have historically been issued for indeterminate terms, subject to "reasonable" readjustment at periodic intervals. Utah opposes the blanket imposition of all current statutory and regulatory requirements on existing federal coal leases without regard to the particular factual circumstances of each lessee.

Q.8. Utah favors providing existing federal coal leases the option to continue to hold existing leases although nonproducing for a significant period conditioned upon the payment of a minimum royalty. Utah endorses the industry's position concerning advance or minimum royalties which was communicated to the Linowes' Commission by representatives of the American Mining Congress and National Coal Association.

Q.9. Advance royalty payments should be recoupable out of production royalties. Providing for recoupment would not impede the Government's effort to curtail speculative lease holding. There is currently little, if any, speculative holding of federal coal leases. Moreover, the Government is not injured by providing for recoupment since its ultimate objective - production of the federal coal with concomitant collection of royalty income - would be achieved. Moreover, the former speculators in federal coal did so because there was no cost associated with holding federal coal. The typical speculator would not wish to endure the holding costs for federal coal which would be required if a minimum royalty was imposed, unless there was some reasonable prospect that the coal could be produced at some foreseeable time.

Q.10. Either of the approaches mentioned - outright repeal of the logical mining unit requirement as per S.570 or the H.R. 1934 proposal - would be acceptable to Utah.

Q.11. If a federal coal lease is properly noticed for competitive lease sale, and sufficient information concerning said lease is communicated to all potential bidders, the fact that there is but one bid should not be interpreted to mean that the sale was not a "competitive" sale. The sole bidder has no way of knowing at the time it bids that it will in fact be the sole bidder and the potential for other bidders would require that any bidder maximize its bid if it wished to insure that it would be successful. "Competitive bidding" should not be defined to require more than one bidder.

Q.12. Typically, the bids received for a competitively offered federal coal lease should be considered as fairly reflecting the value of the coal to be leased. What a willing buyer would pay for property is generally considered to define its fair market value. In instances where a federal coal lease is not the subject of competitive bidding, the Minerals Management Service should determine the fair market value of the lease using traditional, tested appraisal techniques.

Q.13. Yes. As between the United States and coal mining companies, federal coal should be in the hands of the mining companies. The most efficient allocation of coal resources demands that the maximum amount of federal coal be placed in the hands of the coal industry where it can be brought into the marketplace in the most timely fashion, and most economically, in response to market demands. The major return on the federal coal to the government results from royalty income, not bonus bids and hence the government does not benefit by deferring federal coal leasing until the demand for coal substantially increases. Given the provisions of the various environmental statutes, there is no environmental risk in having the coal in industry's hands.

QUESTIONS FOR ALL WITNESSES ON PANEL I

Question

1. Utah International Inc. opposes the repeal of Section 2(c) of the Mineral Lands Leasing Act. Utah considers that railroad coal affiliates would have a substantial competitive advantage in any federal coal lease sale and in the sale of coal produced. Any mechanism that would permit railroad affiliates to acquire federal coal leases should be one which eliminates that advantage. Senator McClure's "compromise" measure is flawed for the reason that it provides for exceptions to the operation of the proposed lease mechanism which largely emasculates the benefit of the mechanism and because it fails to eliminate the distinct advantage enjoyed by a railroad affiliate by reason of its control of the mode of transportation for the coal.

Q.2. Yes. Utah believes that the repeal of Section 2(c) would have anticompetitive effects. Repeal would simply enhance the competitive advantage railroads already enjoy.

Q.3. The substantial advantage enjoyed by railroad coal affiliates would generally not be alleviated by slurry pipelines. Certainly the mere passage of slurry pipeline legislation would not eliminate the competitive advantages enjoyed by railroads. Generally speaking, slurry pipelines will not be built in a manner that would cause them to be competitors with railroads, however, in certain instances it is conceivable that slurry pipelines could be built that would compete with railroads. In any case, there is no reason not to enable the construction of slurry pipelines, and federal legislation

1/...

eliminating the obstacles to slurry pipeline construction should be passed.

Q.4. It is Utah's opinion that competition for federal coal would be "substantially enhanced" by cooperative leasing in almost every instance where federal coal is being offered in a so-called "checkerboard" area. It is basically a geological, engineering and marketing question. There are, no doubt, a few instances where competition would not be substantially enhanced by a cooperative leasing mechanism such as cases where there is a complete economic mining unit entirely on federal lands or where there was but one small isolated tract adjacent to railroad coal valuable only in conjunction with the railroad coal.

Q.5 "Potential mining units" should be determined in the same way a "logical mining unit" is determined. That is, a potential mining unit is one in which the geology of the deposits, engineering and marketing data suggests that a block of coal can be mined most economically. There should be no limit on the size of a "potential mining unit."

Shell Mining Company
P.O. Box 2906
Houston, TX 77252

SUBSIDIARY COMPANIES
R&F COAL COMPANY
TRITON COAL COMPANY
TURRIS COAL COMPANY

Jack L. Mahaffey
President

December 16, 1985

Senator John Warner
Chairman, Subcommittee on Natural
Resources Development and Production
U. S. Senate
Washington, D.C. 20510

SUBJECT: RESPONSE TO SUBCOMMITTEE QUESTIONS

Dear Senator Warner:

I appreciate the opportunities which you have afforded to testify at the November 8, 1985 Subcommittee hearing and to address the questions posed in your November 19, 1985 letter concerning amendment of the Mineral Lands Leasing Act. My responses to the Subcommittee's questions are presented in the attachment.

I believe that revision of the Mineral Lands Leasing Act is a matter that requires immediate attention and, therefore, I am grateful for your efforts in holding a hearing to identify the changes needed. I urge continued commitment to produce amending legislation at an early date and, in this regard, I wish to assure you of my continuing support.

Sincerely,

Jack L. Mahaffey

Attachment

BBL8534601

J. L. MAHAFFEY

RESPONSES TO QUESTIONS OF SENATE SUBCOMMITTEE ON NATURAL RESOURCES DEVELOPMENT AND PRODUCTION

DECEMBER 16, 1985

QUESTIONS FOR PANEL I
Submitted by Senator Johnston
FOR THE RECORD

Questions For First Five Witnesses

(1) *Assuming that Congress does not amend Section 2(a)(2)(A) of the Mineral Lands Leasing Act ("MLA"), to your knowledge, how will your company respond?*

- *Will you relinquish noncomplying leases?*
- *Will you assign noncomplying leases?*
- *Will you bring noncomplying leases into production?*

As I stated in my verbal testimony, Shell Mining Company does not face an immediate Section 2(a)(2)(A) problem. We hold two pre-1976 federal coal leases in Wyoming, one of which is producing and the other, acquired by assignment, has not been held by Shell for 10 years.

Shell previously held a potentially non-complying lease in Montana which we surrendered after evaluating it as not being competitive in the present market. Considerable investment and effort had been expended toward permitting and mine design.

(2) *What do you think of suggestions that Section 2(a)(2)(A) requirements should be imposed prospectively on noncomplying leases obtained through assignment?*

Shell currently holds an assigned federal coal lease and is diligently pursuing its development. Extensive engineering, permitting and marketing efforts are ongoing.

We acquired the lease from a competitor in the expectation of having it in production within 10 years of acquisition and we expect to be successful in that effort. We did not and do not expect to produce commercial quantities by mid 1986.

Shell continues to rely on the Section 2(a)(2)(A) 10 year holding period relative to this lease as we make major investments of money and effort.

Prospective imposition of the Section 2(a)(2)(A) development restriction on past or future "arms length" assignments of pre-1976 leases exists since the assigned lease must be developed within ten years. If you mean to suggest imposing the 1986 commercial development date on all future assigned leases, I believe by doing so you will frustrate legitimate development plans and expectations.

BBL8533701

I do not expect that a rash of assignments will occur. There will be assignments made with expectations that the assignee has more viable options to bring the lease into production than does the assignor. These transactions should be afforded the benefit of the "has held for 10 years" provision since they will most likely result in a higher economic return to the public than might be expected by forcing lease surrender.

(3) *What do you think is a reasonable time deadline for the diligent development of federal coal leases?*

As expressed in my verbal testimony, I believe that in today's circumstances, and for the foreseeable future, an inflexible mandate to achieve full commercial production within 10 years of lease issuance is extremely unrealistic.

As we view the situation today, it probably requires somewhere between 12 and 14 years to bring a lease into full commercial production. Should market conditions change, this time could significantly increase or decrease.

Ten years from lease issuance probably is sufficient to ascertain whether the lease development project is commercially viable. Therefore, providing a mechanism to continue the lease for an additional period by payment of recoupable advance royalty is appropriate. This mechanism will force realistic evaluation of individual leases without frustrating development opportunities. I would suggest that the Congress consider providing for an advance royalty payment period of 10 years.

(4) *Section 2(a)(2)(A) of the MLA provides that lessees with non-producing pre-1976 federal coal leases will be ineligible to obtain new leases for any minerals under the MLA if they do not bring their leases into production by August 4, 1986. S.372, S.570, and S.913 provide relief from this deadline. Some argue that these bills in effect penalize companies who have already taken steps to comply. What is your response to this argument?*

Where a lessee has a Section 2(a)(2)(A) lease acquisition restriction, S372 would provide for an economic penalty on any new lease acquired and S913 would forbid acquisition of a new "competitive" coal lease. S.570 would, of course, provide for outright repeal of Section 2(a)(2)(A). Therefore, two of the three bills would impose some sort of penalty for non-compliance. Considering the due diligence requirement of Section 7 and the fact that most of the competitive leases that we are familiar with have been or soon will be readjusted, elimination of a portion of the non-development penalty does not seem to offer too great a competitive disadvantage to complying companies. As opposed to relying on Section 2(a)(2)(A) to accelerate development or restrict new lease acquisitions, Section 7 can be relied on to force development or surrender. Because they are no longer constrained by Section 2(a)(2)(A), additional participants might be expected in a lease sale. Their participation is not likely to change what Shell Mining Company would be willing to pay for a lease, but should reassure government and the public regarding the question of fair market value being received for any leases awarded through the sale.

Judging from the position of not having an immediate Section 2(a)(2)(A) problem, we do not see elimination of the Section as imposing any significant added penalty.

(5) *S. 372 would allow lessees to acquire new federal coal leases upon the turnback of noncomplying pre-1976 leases with equal tonnage. The House bill also contains a turnback provision but includes a coal-region factor for use in determining how much coal must be turned back. Please elaborate on your views of these turnback provisions.*

Shell Mining Company has no federal acreage available for turn back. I recognize however that many soon to be non-complying Section 2(a)(2)(A) leases constitute significant investment for a number of companies and that allowing some recoupment of this investment by turn back as opposed to added holding fees deserves consideration as a mechanism for providing a measure of compliance flexibility.

(6) *S. 372 would allow lessees holding only one or two noncompliance leases to acquire new federal coal leases upon the payment of higher rent on the new coal deposits. What is your view on this proposal?*

I would prefer to see a recoupable advance royalty imposed on the old lease or leases in non-compliance with Section 2(a)(2)(A). Imposition of the penalty on the new lease reduces it's competitiveness and reduces the amount the non-complying lessee could bid to acquire the new lease. Imposition of the penalty on the old lease forces a decision as to that lease's ultimate economic competitiveness and a continuing reevaluation of the decision to hold the lease.

The holding of non-complying acreage subject to an increased non-recoupable economic penalty, such as rent, appears to be a less effective option which may needlessly force premature surrender because the development economics are unfavorably impacted by the non-recoupable cost of maintaining the lease.

BBL8533701

(7) *Legislation providing for the payment of advance escalating royalties in lieu of production could require that lessees exercising this option must agree to the revision of their federal coal leases to reflect all statutory and regulatory requirements currently in effect. Could you support this proposal?*

Revision of lease terms is currently provided for at the time of lease readjustment. I believe it would be better policy to leave matters of increased lease obligations, other than a possible economic penalty for Section 2(a)(2)(A) non-compliance, to the statutorily mandated lease readjustment date.

Section 2(a)(2)(A) does not unilaterally amend a non-complying lease, it prohibits acquisition of a new lease. The granting of relief from the non-compliance penalty through a money payment should be viewed as distinct from changing the terms of an existing lease.

(8) *S.372 and S.570 both amend Section 7 of the MLA to allow lessees to continue to hold nonproducing leases for up to 20 years upon the payment of an advance escalating royalty in lieu of production for years 11 through 20. Please provide your views on this proposal.*

The advanced royalty proposed in both S.372 and S.570 is an escalating payment which will force continual assessment of a lease's development potential. I believe this is the objective originally intended, i.e., a mechanism to exert pressure on a lessee to prevent the holding of a lease which realistically cannot be developed. While I would recommend a lower percentage royalty than contained in these bills, I believe the escalating nature of the payment will force the making of difficult decisions in a timely manner, while not excessively burdening the initial years of non-development.

At present we believe it will require at least 12 to 14 years from lease acquisition to full development. Changing market conditions could significantly increase or decrease this estimate.

One additional point that I would like to make is that I do believe the question of defining "production in commercial quantities" should be revisited so that leases nearing commercial development at the ten year time point are not either forfeited or used to prevent new lease acquisition because of an inflexible rule. Consideration should be given to efforts and expenditures, and not just to an arbitrary quantity of production, in deciding whether an operator satisfies either Section 2(a)(2)(A) or Section 7 diligence.

(9) Do you think that such advance royalty payments should be recoupable against production royalties? In your view, would full recoupability impede the government's efforts to curtail speculative lease holding?

I do believe that any advance royalty payment should be recoupable. I really doubt that allowing recoupability of the payment will have any adverse effect on prevention of speculation. Lessees, no matter what their intent in acquiring a lease, are not going to commit to increasing lease holding costs unless they believe there is a realistic possibility of development. The otherwise recoupable payment is lost, of course, if there is no development. Allowing recoupment simply affords the opportunity to offer the coal produced from the lease on a competitive basis with other federal and private leases. Recoupability assures that the best coal will be economically producible, as opposed to excluding it from the market by imposing an additional burden. It thus assures the best buy for the consumer.

(10) S.570 would totally repeal the requirement that logical mining units (LMUs) be contiguous. A proposal before the House of Representatives (H.R. 1934) would allow noncontiguous areas to be incorporated into an LMU only if they are within reasonable proximity of each other and under the effective control of a single operator and incorporated into a single operation.

- *Do you endorse either complete repeal or the House approach?*

I endorse the House approach to the question of non-contiguous leases being included in an LMU.

I do believe, however, that, the Department of Interior could be relied upon to permit LMU establishment only where the leases are related to a single operation in some appropriate manner, should the Senate approach be incorporated into law.

(11) S.372 contains a provision defining "competitive bidding" as the receipt of bids by at least two bidders. Please comment on this method of ensuring that fair market value is obtained for federal coal.

Competitive bidding should not be defined so as to require that any specific number of bids actually be received. Rather, a competitive bidding situation exists when a lease is made available for competitive bids. A requirement that at least two bids be received might require the Government to forego significant revenue if one bid of fair market value is received for a lease.

(12) *What steps do you think should be taken to ensure that fair market value is obtained for federal coal?*

I would think that so long as the lease for which competitive bids have been solicited has been properly advertised, fairly described and the terms and conditions of sale accurately set forth, a bid by one or more qualified bidders contrasted with the Department of Interior's estimate of fair market value can be expected to establish fair market value at the time of sale.

(13) *Do you think that current market conditions support additional coal leasing at this time? Why or why not?*

Current market conditions are in part the result of transient influences such as working down stockpiles developed in anticipation of a strike and competition from alternate fuel sources. Supply and demand data suggest only limited growth in the coal market for the very near term. However, because of the uncertainties inherent in forecasting, the time required to prepare for sales and to develop federal coal leases, and the need to lease by-pass tracts, etc. federal coal leasing should not be suspended. The coal leasing program needs to be in place and working.

Questions For All Witnesses on Panel I

(1) *As you know, Senator McClure has introduced two amendments pertaining to Section 2(c) of the Mineral Leasing Act. One amendment would repeal that provision. The other apparently represents an effort to reach a compromise position on the issue. Could you support both amendments?*

I do not support either amendment since neither would assure a truly competitive leasing or transport result.

(2) *Do you think that complete repeal of Section 2(c) would have anti-competitive effects?*

I believe the railroad coal company affiliates would be advantaged over other coal companies if complete repeal of 2(c) occurred without assurances of a competitive situation relative to lease acquisition in the checkerboard area and transportation in the area of their parent company's exclusive railroad service.

(3) *Do you think we could alleviate concerns about these anti-competitive effects in the area of coal transportation by moving forward with coal slurry legislation?*

- *What are your views on coal slurry?*

Passage of coal slurry eminent domain legislation is one, but not the only, element necessary to alleviate the anti-competitive effects of Section 2(c) modification or repeal.

I strongly support passage of coal slurry legislation but would emphasize that it cannot be considered an even exchange for repeal of Section 2(c). The possibility of slurry line construction will not exert the necessary economic pressure to assure a coal operator competitive equality with a railroad coal company affiliate within the railroad's area of exclusive service. In my view, the existence of competitive rail transportation is also required.

(4) *Senator McClure's Amendment No. 801 provides that railroads or affiliated companies leasing federal coal must comply with certain conditions (such as cooperative leasing and sharing of exploration data) only if the Secretary of the Interior finds that competition for the federal lease would be "substantially enhanced thereby." What criteria do you think the Secretary should apply in making the determination that competition would be "substantially enhanced?"*

- *Can you think of circumstances under which competition would not be substantially enhanced by the sharing of data or the guarantee of cooperative leasing?*

I doubt whether you can develop criteria to answer the question of whether there will be a "substantial enhancement of competition" by requiring cooperative leasing.

The question of competitive enhancement is best left to the market place, on a case by case basis, rather than to criteria. This would require that all tracts in the checkerboard be offered cooperatively. Even if there are no other bidders, and therefore presumably a cooperative lease offering was not needed to assure competitive enhancement, it is probable that the offer to cooperatively lease would help assure a fair return on the federal lease.

I cannot suggest a circumstance under which competition in the checkerboard area would not be substantially enhanced by a data sharing and cooperative leasing offer. Even in the instance of a deminimus federal lease interest in the overall potential mine, the market place should determine lack of interest, as it does now with by-pass tracts.

(5) *Amendment No. 801 employs the term "potential mining unit." What criteria do you think the Secretary of the Interior should apply in designating "potential mining units?"*

- *Should there be limitations on the size of the "potential mining units?" If so, what?*

I think the term "potential mining unit" would be so specific to a particular circumstance that I hesitate to suggest criteria or to offer a limitation on size.

I would think that only the input received in response to a specific cooperative lease sale offer would have meaning in validating or quantifying any "potential mining unit."

COAL LEASING
November 8, 1985

Questions for Coal Company Panelists

(1) *You are familiar with the amendments which Senator McClure has introduced on Section 2c. I would like to hear from each of you about the provisions of these amendments acceptable to you; the provisions which are not acceptable and why?*

Cooperative leasing within the checkerboard area, would be acceptable. Railroad coal company affiliate federal lease ownership outside of the railroad parent company area of exclusive service would be acceptable.

Repeal of Section 2(c) to allow railroads or their coal company affiliates to hold federal coal leases where they are the exclusive railroad transporter is not acceptable because of its serious potential for being anti-competitive.

The acreage limitation suggested in the amendment does not appear to be very meaningful. There are restrictions in the present law and it is not clear to us how the proposed new restriction adds much of significance relative to the question of competitiveness.

The remedy suggested for an aggrieved shipper seems ineffective since it would be offered apparently only to the utility shipper, as opposed to the competing coal producer, and much more importantly, only after the railroad coal company affiliate had been awarded the contract for the coal sale.

(2) *Recognizing that the rail affiliates are today willing to accept 2c modification rather than outright repeal; accept for discussion that coal slurry is not tradeable with the railroads, and accept that the Staggers Act is not a coal leasing issue nor the jurisdiction of this Committee, what 2c provisions or modifications are acceptable to your company?*

We would have no problem with data sharing and cooperative leasing within the checkerboard, but if the railroad coal company affiliate is to obtain the federal lease some assurance is required concerning competitive fairness in the transportation of the coal vis-a-vis other coal mine operators. Railroad coal company affiliate ownership of federal coal leases outside of their checkerboard area and their parent railroad company's exclusive rail service area constitutes no problem.

If the railroad coal company affiliates are to be allowed to own federal coal leases in the area of their parent company's exclusive rail service several possible solutions to the transportation aspect of the problem were suggested in Mr. Holsten's November 8, 1985 testimony, namely:

- Require a rail carrier which provides transportation services for its coal affiliate and for a competing coal company to do so under public tariffs subject to challenge by affected persons;
- Require a railroad intending to provide transportation services for its coal affiliate and for a competing coal company to publish its proposed tariffs in advance and to provide a procedure whereby an affected coal company could challenge these tariffs under guidelines designed to prevent an unfair allocation of profits between the transportation and coal functions of the railroad and its affiliate;
- Require a railroad which competes with a coal company to grant greatly expanded competitive access rights to the coal company or another shipper of it's choice.

I believe the most workable solution would be to allow competitive railroad access rights. Essentially create a situation where a company and its affiliates can mine or transport the coal, but not be granted the exclusive right to do both.

(3) As described in the McClure amendment modifying Section 2c, would you agree that allowing railroad coal company affiliates to hold and produce from Federal coal leases in any area that offers head-to-head competitive rail service lacks the controversy of an outright repeal of Section 2(c), and therefore would be acceptable to you?

We would have no objection to railroad coal company affiliates holding and producing from federal coal leases in areas outside the checkerboard area that offer head-to-head competitive rail service. We agree that this prospect lacks the controversy of outright Section 2(c) repeal as far as the transportation aspect of the problem is concerned. The need for competitive leasing within the checkerboard area must also be addressed legislatively.

(4) Would you be opposed to a railroad coal affiliate owning and producing coal from Federal coal leases in those areas where competitive rail transportation exists?

For instance, where the Burlington Northern and UP/Chicago and North Western provide head-to-head rail competition of the Powder River Basin you would not object to either of the rail affiliated coal companies (Meridian or RME) holding Federal leases and producing coal in that area?

As stated in answers to other questions, we would not be opposed to railroad coal company affiliates owning and producing federal coal leases in those areas outside the checkerboard area where competitive rail transportation exists.

Peabody

PEABODY HOLDING COMPANY, INC.

[illegible] Street, N.W.
Suite [illegible]
Washington, D.C. [illegible]
[illegible]

December 17, 1985

The Honorable John W. Warner III
United States Senate
421 Russell Senate Office Bldg.
Washington, D. C. 20510

RE: Committee on Energy and Natural Resources

Dear Senator Warner:

In your letter of November 19, 1985 you requested that I respond to a set of questions as follow-up to the recent hearing held by your subcommittee on the issue of coal leasing. I have enclosed my responses to those questions.

Additionally, I would like to thank you for scheduling the coal leasing hearing and urge you to encourage the full Committee on Energy and Natural Resources to act swiftly to provide to the coal industry the urgently needed relief from the overbearing requirements of Sections 2(a)(2)(A) and 7 of the Mineral Lands Leasing Act.

Sincerely,

Wayne T Ewing

Wayne T. Ewing
President
Peabody Development Company

WTE:mm

Enclosure

cc: Mr. Patrick Sullivan
Professional Staff Member
Subcommittee on Natural Resources
Development and Production
358 Dirksen Senate Office Bldg.
Washington, D. C. 20510

United States Senate
COMMITTEE ON
ENERGY AND NATURAL RESOURCES
WASHINGTON, DC 20510

November 19, 1985

Mr. Wayne Ewing
President
Peabody Development Company
301 N. Memorial Drive
St. Louis, Missouri 63116

Dear Mr. Ewing:

As Senator McClure mentioned at the end of the recent hearing held on coal leasing before the Natural Resources Development and Production Subcommittee, there would be additional questions submitted in writing to the witnesses appearing before the Committee. He also indicated that responses to such questions should be returned to the Subcommittee as expeditiously as possible. Therefore, I would appreciate your prompt response to the attached questions.

I regret that the tragic flooding in Virginia prevented me from chairing the hearing, but I thank you for your excellent testimony and your willingness to respond to oral questioning by the various Senators during the hearing.

Sincerely,

John Warner

John Warner
Chairman, Subcommittee on Natural
Resources Development and Production

JWM/ps/er

QUESTIONS FOR PANEL I

Submitted by Senator Johnston

FOR THE RECORD

(A) Questions For First Five Witnesses

(1) Assuming that Congress does not amend Section 2(a)(2)(A) of the Mineral Lands Leasing Act ("MLA"), to your knowledge, how will your company respond?

- Will you relinquish noncomplying leases?
- Will you assign noncomplying leases?
- Will you bring noncomplying leases into production?

(2) What do you think of suggestions that Section 2(a)(2)(A) requirements should be imposed prospectively on noncomplying leases obtained through assignment?

(3) What do you think is a reasonable time deadline for the diligent development of federal coal leases?

(4) Section 2(a)(2)(A) of the MLA provides that lessees with nonproducing pre-1976 federal coal leases will be ineligible to obtain new leases for any minerals under the MLA if they do not bring their leases into production by August 4, 1986. S.372, S.570, and S.913 provide relief from this deadline. Some argue

that these bills in effect penalize companies who have already taken steps to comply. What is your response to this argument?

(5) S.372 would allow lessees to acquire new federal coal leases upon the turnback of noncomplying pre-1976 leases with equal tonnage. The House bill also contains a turnback provision but includes a coal-region factor for use in determining how much coal must be turned back. Please elaborate on your views of these turnback provisions.

(6) S.372 would allow lessees holding only one or two noncompliance leases to acquire new federal coal leases upon the payment of higher rent on the new coal deposits. What is your view on this proposal?

(7) Legislation providing for the payment of advance escalating royalties in lieu of production could require that lessees exercising this option must agree to the revision of their federal coal leases to reflect all statutory and regulatory requirements currently in effect. Could you support this proposal?

(8) S.372 and S.570 both amend Section 7 of the MLA to allow lessees to continue to hold nonproducing leases for up to 20 years upon the payment of an advance escalating royalty in lieu

of production for years 11 through 20. Please provide your views on this proposal.

(9) Do you think that such advance royalty payments should be recoupable against production royalties? In your view, would full recoupability impede the government's efforts to curtail speculative lease holding?

(10) S.570 would totally repeal the requirement that logical mining units (LMUs) be contiguous. A proposal before the House of Representatives (H.R.1934) would allow noncontiguous areas to be incorporated into an LMU only if they are within reasonable proximity of each other and under the effective control of a single operator and incorporated into a single operation.

- Do you endorse either complete repeal or the House approach?

(11) S.372 contains a provision defining "competitive bidding" as the receipt of bids by at least two bidders. Please comment on this method of ensuring that fair market value is obtained for federal coal.

(12) What steps do you think should be taken to ensure that fair market value is obtained for federal coal?

(13) Do you think that current market conditions support additional coal leasing at this time? Why or why not?

(B) Questions For All Witnesses on Panel I

(1) As you know, Senator McClure has introduced two amendments pertaining to Section 2(c) of the Mineral Leasing Act. One amendment would repeal that provision. The other apparently represents an effort to reach a compromise position on the issue. Could you support both amendments?

(2) Do you think that complete repeal of Section 2(c) would have anti-competitive effects?

(3) Do you think we could alleviate concerns about these anti-competitive effects in the area of coal transportation by moving forward with coal slurry legislation?

- What are your views on coal slurry?

(4) Senator McClure's Amendment No. 801 provides that railroads or affiliated companies leasing federal coal must comply with certain conditions (such as cooperative leasing and sharing of exploration data) only if the Secretary of the Interior finds that competition for the federal lease would be "substantially

enhanced thereby." What criteria do you think the Secretary should apply in making the determination that competition would be "substantially enhanced?"

- Can you think of circumstances under which competition would not be substantially enhanced by the sharing of data or the guarantee of cooperative leasing?

(5) Amendment No. 801 employs the term "potential mining unit." What criteria do you think the Secretary of the Interior should apply in designating "potential mining units?"

- Should there be limitations on the size of the "potential mining units?" If so, what?

QUESTIONS SUBMITTED FOR MR. EWING

PEABODY COAL COMPANY

FOR THE RECORD

C)

1. Does Peabody Coal Company own fee coal reserves which adjoin federal coal reserves?
2. If so, where are these reserves?
3. Do you feel that you ought to be able to bid on and lease these adjoining federal coal reserves?
4. If so, do you feel that you have an unfair competitive advantage on bidding on the federal coal because you own the adjoining private coal in fee and pay no royalties on production from the private tracts?
5. Do you feel that you should be required to enter into a cooperative leasing arrangement as a condition to your bidding on the adjoining federal coal reserves?

COAL LEASING
November 8, 1985

Panel I Sen. Ford
Ford

Questions for Coal Company Panelists

(D)

1. You are familiar with the amendments which Senator McClure has introduced on Section 2c. I would like to hear from each of you about the provisions of these amendments acceptable to you; the provisions which are not acceptable and why?

2. Recognizing that the rail affiliates are today willing to accept 2c modification rather than outright repeal; accept for discussion that coal slurry is not tradeable with the railroads, and accept that the Staggers Act is not a coal leasing issue nor the jurisdiction of this Committee, what 2c provisions or modifications are acceptable to your company?

3. As described in the McClure amendment modifying Section 2c, would you agree that allowing railroad coal company affiliates to hold and produce from Federal coal leases in any area that offers head-to-head competitive rail service lacks the controversy of an outright repeal of Section 2(c), and therefore would be acceptable to you?

4. Would you be opposed to a railroad coal affiliate owning and producing coal from Federal coal leases in those areas where competitive rail transportation exists?

For instance, where the Burlington Northern and UP/Chicago and North Western provide head-to-head rail competition of the Powder River Basin you would not object to either of the rail affiliated coal companies (Meridian or RME) holding Federal leases and producing coal in that area?

(A)

Questions Submitted by Senator Johnston

1. In the absence of an amendment to Section 2(a)(2)(A) of the Mineral Lands Leasing Act (MLA), it is unlikely that Peabody will either relinquish or assign leases which may then become non-complying. The fact is that all of Peabody's presently held pre-1976 federal coal leases — which number 10 — are connected with ongoing coal mining operations. Yet, for a variety of reasons, even this fact may not prevent Peabody from becoming subject to the prohibitions of Section 2(a)(2)(A). One Peabody mine, involving six (6) federal coal leases and which has been producing coal since 1971, may be unable to meet the diligent development standards for some of those federal leases, and that situation may then subject Peabody to the Section 2(a)(2)(A) prohibition. This predicament may arise as a result of the inflexibility of the contiguity requirement for logical mining units (LMU's) contained in Section 5 of the Federal Coal Leasing Amendments Act of 1976 (Section 2(d)(1) of the MLA). This concern was more fully addressed in Peabody's written testimony presented during the subject hearing.

   Another Peabody mine, which has begun coal shipments this year under a long-term contract, will not have achieved the required minimum production (1 percent of recoverable reserves) by the August 4, 1986 statutory deadline. Thus, it too may subject Peabody to the prohibitions of Section 2(a)(2)(A).

   In neither of these cases would it be in the best interests of Peabody nor of the federal government (since these leases are within the planned mining area of the respective mines) for those leases to be relinquished or assigned.

   As for bringing these "non-complying" leases into production, that is exactly what Peabody is attempting to do. Yet, despite diligent efforts to do so, it may still be impossible to reach the statutory minimum production by the August 4, 1986 deadline. Let me point out however, that Peabody's efforts to bring these leases into production is not strictly an attempt to meet the deadline set by Section 2(a)(2)(A). The overriding consideration in the development of these leases has been the acquisition of an appropriate market for the specific quality and quantity of coal from the areas within which these leases are located. A successful coal operator cannot produce coal without a market, and cannot obtain a market for coal unless he has a sufficient quality and quantity of coal within a location which can serve the market desired. These requirements necessitate the maintenance of an extensive producing as well as non-producing inventory of coal reserves by quality, quantity and location.

2. Your second question is somewhat ambiguous and we find that we are unable to interpret exactly what it is you are asking. Rather than attempting to respond to a possible misinterpretation of your question and thereby have our response misinterpreted, we will decline to respond. We will mention however, that our confusion arises from a lack of understanding on our part as to how you intend for the term "prospectively" to apply. When would the Section 2(a)(2)(A) requirements apply to assigned leases?

3. A statutorily mandated time deadline for the diligent development of federal coal leases does little to encourage an operator to produce on any specific lease. The true element which determines, to a large extent, when and how quickly a federal coal lease will be developed is the marketplace. No financially responsible operator

can mine coal for which he has no market. However, assuming that a statutory time deadline for diligent development must be imposed, there are several time consuming steps which must be accomplished before an operator can reach what the Department of Interior now calls diligent development (production of 1 percent of the lease's recoverable reserves). These steps and the associated time requirement for each are:

a. development drilling, in order to determine the extent and nature of the coal, its probable mining sequence and production costs for marketing purposes (several months up to 1 year or more);

b. marketing (an indeterminate amount of time dependent upon a variety of factors), (best case: 2 years minimum);

c. baseline data gathering for environmental purposes (a minimum of 1 year, more often than not, 1 1/2 to 2 years);

d. preparation of the mine plan application (1 to 2 years);

e. approval of the mine plan application by federal and state agencies (a minimum of 1 year, often 2 or 3 years). If an Environmental Impact Statement is required, then this step requires a minimum of 2 years;

f. construction of the mine (1 to 2 years depending upon size of mine); and

g. start-up and actual production of coal in commercial quantities, i.e., 1 percent of the recoverable reserves of the lease or LMU (depends upon the size of the leasehold, can be several years in the case of large reserves), (minimum of 3-4 years, sometimes more).

The above time requirements must be recognized to have been estimates based upon favorable assumptions. Such favorable assumptions are that a market for the specific quantity, quality and location of reserves does exist following lease acquisition. And, it must be assumed that the operator's bid for the coal supply contract and the ensuing negotiations over the terms of that contract do actually result in the execution of a contract. It should also be recognized that the size of the coal reserve can have a great affect on the stated time limits, especially in the preparation of environmental impact statements and background environmental data collection.

We would also point out that while some of the stated steps may overlap — for example, an operator can prepare parts of his permit application while environmental studies are ongoing — each succeeding step relies to a large degree on the results of the previous steps. Thus, under the best of circumstances, the minimum number of years necessary for an operator to reach the presently set diligent development requirement would be 10 to 13 years and perhaps more.

4. We believe that the coal industry in general truly needs relief from Section 2(a)(2)(A) of the MLA. Peabody itself while attempting to diligently develop all of its currently held pre-1976 federal coal leases may nevertheless find itself subject to the Section 2(a)(2)(A) prohibition. This may be true despite the fact that all of those leases are associated with ongoing coal mining operations, and despite the fact that Peabody has also relinquished or may soon relinquish several other of its pre-1976 leases, as well as Preference Right Lease Applications. More important than the

argument that relief from the deadline may seem to penalize those who have attempted to comply, is the fact that failure to provide relief will in fact penalize those who are and have been diligently attempting to comply.

5. The "turnback" provision which you refer to in your question is only one of several proposed alternative methods of complying with MLA Section 2(a)(2)(A). While, at the present time, we do not believe that Peabody would utilize this provision itself, it is certainly a viable alternative and one which we support.

6. The provision of S. 372 which allows lessees holding only one or two non-complying leases to acquire new federal coal leases upon the payment of higher rent on the new coal deposits is again one of several proposed alternatives. It appears to be attractive to those operators holding a minimum of non-complying leases. Peabody certainly believes that the concept proposed in this alternative has merit, however, we do not believe that it should be restricted by the number of non-complying leases held. This proposal should be expanded to allow any lessee which holds non-complying leases to acquire new federal coal leases by the payment of an increased rent on the newly acquired coal deposits.

7. Peabody could not support this proposal. Such a requirement is unwarranted for several reasons. First, the proposal, by allowing an operator to pay royalties in lieu of production, recognizes that legitimate situations will exist where an operator will be unable to produce from its federal coal lease in a year when it would otherwise be required to do so. The payment of the advance escalating royalties in lieu of production is itself a penalty. Imposing further penalties — revision of federal coal leases to reflect all statutory and regulatory requirements currently in effect — would negate the recognition of the legitimacy of such non-producing year situations. Second, by imposing all statutory and regulatory requirements upon lessees utilizing the advance royalties in lieu of production option, the lessee would then become subject to terms and conditions which he had not contemplated prior to obtaining his lease. In the case of pre-1976 federal coal leases which are currently being developed, the lessee has determined production schedules and entered into coal sales contracts in reliance upon the then existing terms and conditions of his lease. Changing such terms and conditions would severely penalize him in spite of the fact of the development of his lease. This is especially true with respect to the royalty rate which the lessee would then be subject to. Thirdly, the requirement suggested in your question would have the effect of negating the decision made by several operators in 1982 to become subject to the statutory and regulatory requirements then in effect.

8. Peabody supports the proposals which would amend Section 7 of the MLA to allow lessees to continue to hold non-producing leases for up to 20 years upon the payment of a royalty in lieu of production for years 11 through 20. However, this support is premised upon the notion that the amount to be charged to the lessee under such circumstances would be reasonable. The rate should be set at a figure which would not be so onerous that it defeats the flexibility which this type of provision is meant to provide to the lessee.

9. It is our opinion that such advance royalty payments in lieu of production should be recoupable against future royalties due as a result of production. This is the nature of advance royalties. They permit the lessor (the federal government) to receive a steady stream of income from royalties regardless of the fact that there may have been no production from the lease. The lessee is paying for the coal while it is still in the ground. Once that coal is actually mined, the lessee should receive the

benefit of his having previously paid the royalty on it. Otherwise, the lessee is made to pay twice for the same coal. Recoupability of advance royalties provides the lessee with an incentive to produce from the lease. Continued non-production from the lease would otherwise result in a loss of the investment of the advance royalties in lieu of production. Naturally, a lessee will endeavor to place the lease upon which he has recoupable advance royalties outstanding into production prior to those upon which he has no recoupable advance royalties outstanding.

For these same reasons, we do not believe that full recoupability impedes the government's efforts to curtail speculative lease holding.

10. The logical mining unit (LMU) contiguity requirement should be either repealed in its entirety, or modified as was suggested in H.R. 1934. For several operators, and Peabody in particular, this contiguity requirement will create unworkable situations.

    One Peabody mine contains six (6) federal coal leases as well as other properties and is physically divided into three (3) separate areas by narrow quarter-mile strips of land. Peabody has been unable to obtain the necessary control of these intervening strips of land and has therefore, under present law, been unable to form an LMU. This lack of technical contiguity forces Peabody to treat the three (3) areas as separate production areas for purposes of Sections 2(a)(2)(A) and 7. The mine which is located in this area was constructed and operating well before the enactment of the Federal Coal Leasing Amendments Act of 1976. The surface mineable production of this mine is dedicated by a coal supply agreement for delivery to a mine-mouth powerplant and neither the production requirements nor economic or environmental prudence warrant the simultaneous production of coal from all three areas. Yet, if Peabody does not produce coal from all three (3) areas it may become subject to the Section 2(a)(2)(A) prohibitions. Thus, the contiguity requirement for LMU's is forcing this mine into a situation where Peabody will be in non-compliance with Section 2(a)(2)(A) and potentially Section 7 as well. While Peabody recognizes the necessity to maintain some control over the formation of LMU's, the strict contiguity requirement inhibits the sound operation of areas which should be formed into an LMU.

11. The vast majority of the income which the federal government receives from federal coal is recieved as royalties as opposed to the bonus bid. The competitive bidding process is designed to allow competing interests to bid against one another for the right to mine a certain area. We do not believe that the purpose of that process was intended as the federal government's "method of ensuring that fair market value is obtained for federal coal". The federal government utilizes other methods to ensure that fair market value is received for federal coal. Such other methods include the setting of minimum acceptable bids.

12. The true determining force which will ensure that the federal government will receive a fair return on the federal coal which it leases is the marketplace. That same force determines what a private lessor or corporate lessor will receive if it wishes to lease out coal which it owns. As you well know, the series of factors involved in that marketplace determination is complex and I believe it is unnecessary for the federal government to attempt to set forth specific steps to be taken which would have the effect of circumventing the marketplace.

13. Claims have been made that more than enough federal coal is now under lease than can be utilized over the next several decades. In total tonnage, this may be true. However, coal is not a fungible commodity. Many factors come into play when one

attempts to market coal. Coal from different areas may have different heating values (BTU rating) as well as other differing characteristics (i.e., sulfur, ash, volatile matter, and moisture content). It may not be economical, or indeed at all physically possible to transport coal from one part of this country to a customer located in another part of the country. An industrial or utility boiler may be designed to burn coal which possesses only a certain range of quality characteristics. The coal in West Virginia is not the same as the coal in Kentucky; the coal in Illinois is not the same as the coal in Indiana; the coal in Wyoming is not the same as the coal in New Mexico.

What this means is that coal operators must have an inventory of coals available and at their disposal to bid to supply the needs of the coal purchaser. That inventory must contain a wide variety of quality characteristics and must be available from several different locations to match that inventory with the customer's need.

In order for coal operators to maintain such inventories, it is necessary that the federal government, on a regular basis, make federal coal available for lease. While the coal market at the present time may be "soft", as mentioned earlier, it takes a long time to bring a property into production. And, before a potential customer will accept a bid from a coal operator, that operator must have the appropriate coal under his control.

(B)

1. Peabody is unable to support either of the amendments introduced by Senator McClure with respect to Section 2(c) of the MLA. Neither of those proposed amendments provide the non-railroad-affiliated coal industry with the relief which would be necessary before the rail industry could expand into another industry which relies so heavily upon the railroads for its continued existence. Neither alternative truly addresses and protects against the opportunities for monopolistic practices inherent in a situation where one entity exists as a competitor in the production and marketing phases of an industry, and also controls the transportation mode for a great segment of that industry.

2. Complete repeal of Section 2(c) of the MLA would unquestionably have anti-competitive effects. The commercial coal producer would be forced to ship its coal over the line of a railroad which is also a competitor in the coal business. There is no assurance that a railroad would not give its mining affiliate a preference with respect to the freight rate over the rate which it would offer to a neighboring commercial coal producer requiring similar service. Further, assuming the railroad were to quote the same freight rate to both its affiliate and the non-affiliate coal company, there is no assurance that that freight rate would not be inflated to push the delivered cost of the non-affiliate coal company's product out of competion with that of the affiliate. The railroad would make its profit on the rail rate and sell the coal of its affiliate at below cost in order to obtain the business. Finally, there is always the potential for discriminating treatment by the rail-parent in favor of its affiliate and to the detriment of the non-affiliate. This can be manifested in faster turn around time on trains; quicker service and maintenance; fewer delays, and more efficient operation of its service in general.

3. While Peabody is supportive of legislation intended to make coal slurry a reality, we do not believe that it would provide the means to alleviate our concerns with respect to the anti-competitive effects of a repeal of Section 2(c) of the MLA. The fact that the railroad industry, with respect to the transporation of coal — especially in

the West —, has no competition is one of the major concerns that the notion of repeal of Section 2(c) raises. Slurry legislation, in and of itself would not negate that concern. Slurry pipelines which would actually compete with the railroads in the West would not be a reality for many years to come. Further, there would be no guarantee that they would be competitive with the railroads — hopefully they would. However, the mere passage of slurry legislation will not remove the monopolistic power of the railroads in the transportation of coal.

4. Under Senator McClure's Amendment 801, we would hope that in all situations the Secretary of Interior would determine that competion would be substantially enhanced by the sharing of data and the guarantee of cooperative leasing. However, Senator McClure's Amendment 801 fails to adequately address the non-railroad affiliated coal company's concerns with the transportation monopoly power of the railroads. Without adequately addressing this concern, we do not believe a workable solution to the Section 2(c) problem can be found. We would like to note, however, that the concepts of cooperative leasing and the sharing of data do have merit as they address the non-rail affiliates' leasing concerns, yet, both as contained in Senator McClure's Amendment 801 require further work.

5. The term "potential mining units" is a new term which indeed requires definition in order that Amendment 801 be fully understood. Inasmuch as Amendment 801 was not derived from a suggestion of the non-rail-affiliated coal companies, we are unable to set criteria for or limitations upon that term. We too are curious as to what is intended by that term. Not having been involved in the preparation of Amendment 801, we are unable to give it a definition.

(C)

Peabody Coal Company Questions

1. Peabody Coal Company does own, in its own right, a limited amount of fee coal which adjoins federal coal reserves.

2. The only reserves of Peabody Coal Company which are owned in fee and which also adjoin federal coal reserves lie in the state of Colorado.

3. At the present time, Peabody Coal Company has no intention or desire to bid on and lease the federal coal reserves adjoining its fee coal holding in Colorado. Yet, if the situation arose where it was determined to be desirable to bid on and lease that adjoining coal, then We believe Peabody Coal Company should be permitted to do so.

4. We do not believe that Peabody Coal Company has an unfair competitive advantage on bidding on federal coal which adjoins private coal held in fee. The fee coal was obtained by Peabody Coal Company for the express purpose of a commercial mining operation. Money changed hands and Peabody Coal Company had made an investment in its coal reserves for future mining operations. This was a part of Peabody's existing business practice. While no production royalties are to be paid on the fee coal, an investment which required a cash or exchange outlay was made. Such was not the case with the acquisitions of the checkerboard coal owned by the railroads. Since 1914 it has been recognized by Congress that railroads as common carriers should be separated from any other activity; that transporation should be divorced from production (see written testimony of coal industry panel for Congressional Record cite). Thus, in no sense can it be claimed that the railroads' acquisition of fee coal was a normal part of its business practice or an investment for its future mining operations. They have been prohibited from entering the coal

mining industry since at least 1914. The reasons for that prohibition are still as valid today as they were in 1914. The potential for unfair monopolistic practices far outweigh any rationale raised for allowing the railroads the right to compete with customers forced to ship over their rail lines.

5. For the same reasons stated in question 4 above, we do not believe that Peabody Coal Company should be required to enter into a cooperative leasing arrangement as a condition to bidding on adjoining federal coal reserves. Further, unlike the railroads, the non-rail-affiliated coal companies do not own the vast coal reserves which checker the rail service areas in the western United States. Non-rail-affiliated coal companies own relatively small, widely dispersed coal properties which adjoin federal coal. The railroads own huge areas of coal deposits with equal areas of federal coal interspersed with those properties. Additionally, non-rail-affiliated coal companies do not possess the monopoly on transportation out of the coal reserve areas which is possessed by the railroad companies, and which must necessarily be imputed to their subsidiary coal affiliates.

(D)

1. There are three (3) areas of concern which must be addressed in any attempt to modify Section 2(c) — transportation, leasing and product pricing. Both of Senator McClure's proposals fail to adequately address all three (3) of these areas. With respect to transportation, Senator McClure suggests disclosure of contract and bid information. Unfortunately, such disclosure is after-the-fact; after a transportation contract and coal supply contract have been negotiated and signed. In that situation the business has been lost to the competing coal company long before it has an opportunity to discover if any type of unfair collusion occurred between the railroad and its affiliate. Further, no remedy is offered other than the disclosure of information which may or may not be helpful. The transporation and coal supply contracts still remain in effect.

   Senator McClure's amendment suggests that cooperative leasing and disclosure of data may be an appropriate method of addressing the leasing concerns of the non-railroad affiliates. We believe these concepts have merit but need further refinement. That is, cooperative leasing and data disclosure should be mandatory. The coal leased cooperatively with the federal coal should be leased subject to the exact same terms and conditions and should not be subject to withdrawal by the railroad. The third element which requires mention is product pricing. While this element is, to a certain extent, associated with the transportation issue and the disclosure of contract and bid information suggestions in Senator McClure's amendment, it requires extensive treatment. It is here that it becomes difficult if not impossible to reach a solution. Senator McClure's amendment does not actually address this concern. We believe that any attempt to provide the protection needed in this area would require changes in statutes other than just the MLA.

2. The coal industry is not opposed to entry of railroads or their affiliates into the coal business, provided they do not also ship that coal upon their own rail line for any portion of its carriage. Other than this suggestion, the provisions contained in your question have eliminated most, if not all, of the areas which would have to be involved for the protection of non-rail affiliated coal companies in any attempt to modify Section 2(c).

3. Senator McClure's amendment modifying Section 2(c), does not seem to suggest that allowing railroad coal company affiliates to hold and produce federal coal leases in any area that offers head-to-head competitive rail service lacks the controversy of

outright repeal of Section 2(c). However, accepting that as an interpretation of Senator McClure's amendment, such would be neither true nor acceptable. While such a situation admittedly addresses, to a certain extent, the transportation concerns which the non-rail affiliated coal industry may have, it does nothing to resolve the leasing concerns discussed in the answers above. There may also continue to be concerns in the area of product pricing. This is especially true where a utility customer has the right to pass transportation costs directly through to its customers. The potential exists for the railroad and its affiliate to shift the majority of the cost burden onto the transportation rate, making its package more attractive than that of the independent railroad and the independent coal operator, each of which must reflect his own costs and profit in his own price.

4. Peabody does not oppose the ownership and production of coal from federal coal leases in areas where competitive rail transportation exists, provided the other issues of concern (i.e., leasing and product pricing) are also adequately addressed. All issues of the Section 2(c) problem must be solved as a whole. We do not believe that dealing with only the transportation aspect or only the leasing aspect will be in the best interests of either the railroads or the non-rail affiliated coal companies.

B. R. Brown
Chairman
and Chief Executive Officer

Consolidation Coal Company
Consol Plaza
Pittsburgh, Pennsylvania 15241
(412) 831-4018

January 20, 1986

The Honorable John Warner
Chairman, Subcommittee on Natural
Resources Development and Production
306 Dirksen Senate Office Building
U.S. Senate
Washington, DC 20510

SUBJECT: Federal Coal Leasing Legislation

Dear Mr. Chairman:

Here are my answers to the written questions posed following my testimony on the subject November 8, 1985.

1. Assuming that Congress does not amend Section 2(a) (2) (A) of the the Mineral Lands Leasing Act ("MLA"), to your knowledge, how will your company respond?

Consol currently controls 28 federal coal leases which are not expected to be in production on December 31, 1986. These leases are grouped together within four separate projects as shown in the following table:

Project	Pre-FCLAA Federal Leases
Meeker (Colorado)	6
Coalmont (Colorado)	3
Emery (Utah)	9
Kaiparowits (Utah)	10
TOTAL	28

Consol produces coal from private property within the Emery Project and will assume to incorporate as much of the coal under federal lease into an LMU with the private property as our production will allow. Current market conditions make it impossible to bring any of the other non-producing leases into production.

Consol will relinquish all non-producing leases if it is determined that our parent company (Conoco) will be prohibited from participating in any federal oil or gas lease sale.

Because these federal leases may be subject to diligent development deadlines which, under foreseeable market conditions, are impossible to meet, assigning these leases may be difficult. However, if an opportunity presented itself, Consol would consider assignment as possible relief from the sanctions of Section 2(a)(2)(A).

2. What do you think of suggestions that Section 2(a)(2)(A) requirements should be imposed prospectively on non-complying leases obtained through assignment?

This would eliminate the usefulness of assignment for any pre-FCLAA federal coal lease. It should be noted that any assignment will not bring these federal leases into production. Production from these leases depends on the market not a different operator.

3. What do you think is a reasonable time deadline for the diligent development of federal coal leases?

Because of the long lead time necessary for mine permitting and development and because leases must be maintained to meet future market needs, the leases should provide for a longer term. Rather than a diligence period, we suggest a primary period of 20 years with a 20 year secondary term because these terms are common to private leases.

Diligence requirements accomplish far less than is commonly thought. No company is going to invest the tremendous capital required to produce coal at a loss merely to maintain a lease. Production can not and should not be forced; however, the lease should provide the public with a predictable stream of revenue until production commences. In the private sector, this revenue is achieved through the payment of advance royalties which are recoupable against production royalties. The amount paid in advance royalties for private leases vary but are generally $20 to $25 per acre per year. Based on federal coal leases held to date, the payment of advance royalties alone in this manner would provide the public with a stream of revenue of over $20,000,000 per year.

4. Lessees with nonproducing pre-1976 federal coal leases will be ineligible to obtain new leases for any minerals under the MLA if they do not bring their leases into production by August 4, 1986. S.372, S.570, and S.913 provide relief from this deadline. Some argue that these bills in effect penalize companies who have already taken steps to comply. What is your response to this argument?

Section 2(a) 2(A) is not a compliance requirement. No pre-1976 lease held beyond August 4, 1986, is subject to forfeiture or any other penalty if not in production by that date. Those who have disposed of pre-1976 leases have done so because market conditions have allowed production, incorporation with producing leases into an LMU, or assignment where marketing expectations are high.

5. S.372 would allow lessees to acquire new federal coal leases upon the turnback of noncomplying pre-1976 leases with equal tonnage. The House bill also contains a turnback provision but includes a coal-region factor for use in determining how much coal must be turned back. Please elaborate on your views of these turnback provisions.

Consol strongly endorses a turn back provision. As I stated in my testimony, turn back would be a useful compromise, although we feel that it would be simpler to administer on some sort of acre for acre basis.

First, it allows a company to continue to compete for new leases without actually increasing the number of federal tons it has under lease. As you are aware, the Department of the Interior frequently is criticized at each lease sale for leasing coal when 16 billion tons of coal already exist under lease. To the extent that the turnback concept is utilized, that argument is muted because new coal is leased but "old" coal is returned to the federal domain. Further, the government benefits because the development potential of a company's lease holdings improves, which will ultimately lead to production and the payment of production royalties to the government; and the number of competitors at future lease sales is not restricted, improving the chances for vigorous bidding at each lease sale.

Second, the "turnback" concept begins an orderly process of returning to the federal domain old leases which were not subjected to the land use planning and screening processes to which leases offered today are subjected. Although current environmental statutes guarantee that every lease will be developed in an environmentally sound manner, the turn-back concept may encourage companies to view those leases with the greatest environmental problems as the most likely candidates for relinquishment.

Finally, the turnback concept provides a far more orderly disposition of old undeveloped leases than would otherwise occur if Congress does not amend the current Section 3 provisions. Companies would benefit because we would avoid writing off our books, virtually overnight, a substantial asset base. The Department of the Interior would benefit because lease relinquishments would occur at a far more manageable pace, easing processing demands on the Department. And finally, the taxpayer would gain because revenue losses due to tax writeoffs of the relinquished assets would be minimized.

Let me add that this approach is not an exchange. It is a transaction in which the government receives fair market value for the new lease it offers and imposes, in addition, a penalty on the lessee if that lessee still holds undeveloped pre-1976 leases. The penalty, of course, is the relinquishment of leases by the lessee earlier than the lease terms would otherwise require.

6. S.372 would allow lessees holding only one or two noncompliance leases to acquire new federal coal leases upon the payment of higher rent on the new coal deposits. What is your view on this proposal?

Consol is not necessarily opposed to the concept of "holding fees" as an approach to resolving Section 2(a)(2)(A). However, no holding fee will induce production. A concept similar to holding fees, advance royalties, has been utilized within the private sector for years and has worked quite well. Private advance royalties were not designed to induce production but to provide some stream of income to the lessor until a market developed at which time they are recoupable against production royalties. We believe that this should be included as one of several methods available modifying Section 2(a)2(A).

7. Legislation providing for the payment of advance escalating royalties in lieu of production could require that leasees exercising this option must agree to the revision of their federal coal leases to reflect all statutory and regulatory requirements currently in effect. Could you support this proposal?

There is a need for considerable clarification of that proposal. Lease holders have already elected to include many leases under 1982 regulations. Environmental protection "performance" standards apply to all leases being brought into production. If the question means to suggest that previously issued leases retroactively be made subject to planning and screening procedures currently used to select new leasing areas, we would not support such a requirement.

8. S.372 and S.570 both amend Section 7 of the MLA to allow lessees to continue to hold nonproducing leases for up to 20 years upon the payment of an advance escalating royalty in lieu of production for years 11 through 20. Please provide your views on this proposal.

The payment of advance royalties should provide a stream of income to the lessor until a production occurs. This is common practice and we would support such a payment. However, the assumption that escalating royalties provide some additional incentive to produce is without foundation. The higher these payments are made to be, the more they will burden the project and consequently, the less likely production is to occur.

9. Do you think that such advance royalty payments should be recoupable against production royalties? In your view, would full recoupability impede the government's efforts to curtail speculative lease holding?

Because advance royalties are designed to provide a stream of income to the lessor until production commences (and production royalties are realized) we believe that they should be fully recoupable against production royalties.

In our view, little "speculation" has occurred on federal coal leases, but the exaggerated fear of speculation has often distorted policy decisions. If coal from any federal lease could currently be mined at a profit, it would only make sense to commence production as opposed to losing that market to another operator. Also, because of the time value of money, income should be generated as quickly as possible. The production of federal coal will not be enhanced by prohibiting advance royalties to be recoupable against production royalties.

10. S.570 would totally repeal the requirement that logical mining units (LMUs) be contiguous. A proposal before the House of Representatives (H.R.1934) would allow noncontiguous areas to be incorporated into an LMU only if they are within reasonable proximity of each other and under the effective control of a single operator and incorporated into a single operation.

Do you endorse either complete repeal or the House approach?

We endorse the repeal of the requirement that areas incorporated into our LMUs be contiguous. A company's holding within a single operation can be logically separated by geologic conditions and other physical constraints to mining which are beyond control of the operator. Secondly, the D.O.I. has, in the past, delineated federal lease tracts in such a manner that the successful bidder would acquire federal parcels which are located both within his and his competitor's logical mine block. This assures competition but makes for a time delaying trade with the competitor. It would be unfair to the successful bidder to prohibit him from holding his federal lease parcels in an LMU until such a trade could be made.

11. S.372 contains a provision defining "competitive bidding" as the receipt of bids by at least two bidders. Please comment on this method of ensuring that fair market value is obtained for federal coal.

Consol's opinion regarding fair market value for federal coal leases can be reviewed in the attached statement to the Commission on Fair Market Value Policy for Federal Coal Leasing dated October 21, 1983.

12. What steps do you think should be taken to ensure that fair market value is obtained for federal coal?

See response to question #11.

13. Do you think that current market conditions support additional coal leasing at this time? Why or why not?

It is too late to lease coal to meet current market demands. Leasing now should be for future market demands. Lease acquisition and mine development cannot react quickly to changing market conditions. On a macro-scale, drastic legislative changes could increase overnight the demand for coal which is currently not saleable. Those companies which have previously acquired and developed reserves which now meet the new demand criteria would capture the market.

Prior to investing the tremendous capital needed to construct a coal fired electric generating plant a utility wisely selects a fuel source which can be depended upon to supply fuel at a low cost for a long term. The supplier must first, of course, have the right to produce coal from the lands proposed to be mined. The supplier can not approach the utility with a mere intention to acquire a lease. For this reason, the industry secures and maintains a multitude of leases with hopes of being able to meet currently foreseeable market needs.

The acquisition of coal to supply future markets is common practice within the coal industry and holding leases for a long term should not be misconstrued as price speculation.

Questions For All Witnesses on Panel I

1. As you know, Senator McClure has introduced two amendments pertaining to Section 2(c) of the Mineral Leasing Act. One amendment would repeal that provision. The other apparently represents an effort to reach a compromise position on the issue. Could you support both amendments?

Consol does not support either amendment.

2. Do you think that complete repeal of Section 2(c) would have anti-competitive effects?

Repeal of 2(c) would create the potential for anti-competitive behavior by the railroads and their mining affiliates, principally through the exercise of the enormous discretion in pricing and service which the railroad itself enjoys under the Staggers Rail Act.

3. Do you think we could alleviate concerns about these anti-competitive effects in the area of coal transportation by moving forward with coal slurry legislation?

What are your views on coal slurry?

No. It is unlikely that any major slurry pipeline projects will be built in the next ten years, even were eminent domain provided by federal legislation. In addition, a slurry line may only serve a single mine and a single delivery point -- thus not providing effective competition to the railroad in all the areas where a railroad mining affiliate and railroad could operate

4. Senator McClure's Amendment No. 801 provides that railroads or affiliated companies leasing federal coal must comply with certain conditions (such as cooperative leasing and sharing of exploration data) only if the Secretary of the Interior finds that competition for the federal lease would be "substantially enhanced thereby." What criteria do you think the Secretary should apply in making the determination that competition would be "substantially enhanced"?

Can you think of circumstances under which competition would not be substantially enhanced by the sharing of data or the guarantee of cooperative leasing?

I do not agree with limiting the requirement only to the circumstances where competition would be "substantially enhanced." It would be helpful if the author had included in his remarks regarding this amendment some indication of what he had in mind regarding the term "substantially enhanced."

5. Amendment No. 801 employs the term "potential mining units." What criteria do you think the Secretary of the Interior should apply in designating "potential mining units"?

   Should there be limitations on the size of the "potential mining units"? If so, what?

We suggest that the new term "potential mining unit" not be introduced into the Leasing Act. Apparently, Amendment 801 seeks to make a distinction between logical mining unit, the traditional term used in leasing, and "potential mining unit." However, it is not clear from a reading of the amendment what distinctions the author had in mind. Without some additional insight into the author's reason for the apparent distinction, it is difficult to offer any specific comments.

QUESTIONS SUBMITTED FOR MR. BROWN
CONSOLIDATION COAL CO.
FOR THE RECORD

1. Does Consolidation Coal Company own fee coal reserves which adjoin federal coal reserves?

Yes.

2. If so, where are these reserves?

Emery and Sevier Counties in Utah; Bighorn County, Montana; and Bowman, Slope and Burke Counties, North Dakota.

3. Do you feel that you ought to be able to bid on and lease these adjoining federal coal reserves?

During the federal coal leasing moratorium, the coal industry was forced to acquire private coal and surface properties in order to establish positions in desired market areas. This private coal was, in some cases, interspersed with unleased federal coal. Competition was inherent in that these properties were available to any one choosing to make an offer. In some cases, the development of this private coal depends upon the acquisition of the unleased federal coal. We do feel we ought to be able to bid on and lease these adjoining federal coal reserves.

4. If so, do you feel that you have an unfair competitive advantage on bidding on the federal coal because you own the adjoining private tracts?

We do feel that we have a competitive advantage by virtue of our ownership of the adjoining private coal in those cases where the development of the federal coal depends upon the control of the private coal. However, this competitive advantage is not unfair. The private properties were available to anyone at the time we acquired them. Our ownership of private coal reserves cannot be compared to that of the railroads. The unfair competitive advantage of the railroads lies not so much with their ownership of properties interspersed with federal coal but with their ability to transport coal at a non-competitive cost.

5. Do you feel that you should be required to enter into a cooperative leasing arrangement as a condition to your bidding on the adjoining federal coal reserves?

No. The concept of cooperative leasing has been suggested as a procedure for avoiding the inequity of permitting a railroad mining affiliate to compete actively in an area where the railroad holds monopoly power over transportation of coal while insuring a fair rate of return to the railroad, as lessor, from the development of its coal resources. Because a coal company has no monopoly power over transportation, the cooperative leasing concept is neither useful nor required for the development of the resource in a competitive manner.

Questions for Coal Company Panelists

1-4 You are familiar with the amendments which Senator McClure has introduced on Section 2(c) ... etc.?

I participated in the numerous discussions which the National Coal Association has held to review the Section 2(c) amendments offered by Senator McClure. I believe my views on the issue are fully reflected in the discussion offered by Richard Holsten on behalf of the three associations (NCA, AMC, MARC). I believe a review of that written testimony will address all of the questions in this section.

Please advise if I may be of further assistance to your subcommittee.

Very truly yours,

BRB:lls

Enc.

cc: Carl E. Bagge, National Coal Association
Daniel Gerkin, Mining and Reclamation
Association of America
J. Allen Overton, Jr., American Mining Congress

STATEMENT OF CONSOLIDATION COAL COMPANY TO THE COMMISSION ON FAIR MARKET VALUE POLICY FOR FEDERAL COAL LEASING

OCTOBER 21, 1983

INTRODUCTION

On September 7, 1983 representatives of Consolidation Coal Company (Consol) appeared before the Commission of Fair Market Value Policy for Federal Coal Leasing to relate Consol's opinions concerning the fair market value (FMV) of federal coal. At this testimony, Consol was offered the opportunity to present it's views in writing at a later date. Consol appreciates this opportunity and respectfully submits the following comments.

Although the determination of FMV for federal coal requires the consideration of a multitude of factors, Consol has chosen to comment only on those issues that signficantly affect FMV.

BONUSES, ROYALTIES AND RENTALS

The Federal Government requires production royalties in the amount of 12½% of the selling price for surface mineable coal (statutory) and 8% of the selling price for underground mineable coal (regulatory). Revenues obtained from a surface mining operation which produces four million tons per year for twenty years, and sells the coal for $17.00 per ton would total $170,000,000. Even after discounting these revenues at 10% over the life of the mine the net present value of the royalty payments total approximately $72,365,000. These revenues, however, are not recognized by the government as constituting a significant portion of fair market value.

If the government's only objective is to maximize the upfront revenue, one way to accomplish this would be to lower royalty rates. One would be willing to pay more for a lease with lower royalty rates (more in line with those of private leases), than for a lease with royalties currently required on new federal leases.

Not only do high royalty rates depress the bonus bid, but in some cases high royalty rates sterilize federal coal. In many bypass situations operators are mining coal with royalty rates considerably lower than the current federal rate. When a tract of unleased federal coal is encountered, bypassing that tract and avoiding the higher royalty rate (in spite of the potential increase in mining costs) becomes an economically feasible option (see Appendix 1, Case 3). For this reason it is not only possible for a federal tract to have little or no value to an operator, but in some cases the tract may even have a negative value.

FEDERAL VS. PRIVATE LEASE TERMS

One of the techniques used to determine FMV by the Minerals Management Service (now BLM) has been to compare the value of the federal tract to published prices received by lessors for the leasing of private coal in the same vicinity. Although in place coal values may be similar, this process fails to address the differences in the terms and conditions between private and federal leases. There are several significant areas of difference.

1) Incompatible development terms

Historically, private leases have imposed development requirements which could be satisfied by the payment of advance royalties in lieu of production. A typical private lease would have an initial development period of 20 years with a right to extend the development period for an additional 20 years by paying an advanced royalty. This allows the lessee to maintain the lease until market conditions support production while providing revenue to the lessor.

The imposition of diligent development requirements in new federal leases devalues the lease because of its shorter development period (10 years). Development requirements on federal leases, therefore, increase the overall risk of the project because it forces the lessee to predict market conditions with a higher degree of accuracy than may be possible. Allowing industry to acquire leases in order to satisfy uncertain future market demands without the threat of lease cancellation reduces this up front risk and thus has a positive effect on the value of a lease.

2) Prohibitive lease stipulations

Certain lease stipulations for protecting the environment are imposed on federal leases without reasonable opportunity for mitigation. Because there are no environmental impacts to the "leasing" of federal coal, potential lease stipulations should be "identified" prior to leasing, but no prohibitions should be imposed until mitigation opportunities are evaluated at the mine permit stage.

3) Cost of preparation and submission of various analyses necessary prior to mine permit stage (i.e., Resource Recovery and Protection Plans, etc.)

A federal coal lessee is required to submit within 3 years of lease issuance a "Resource Recovery and Protection Plan" (RR & PP) that addresses the proposed recovery and reclamation of a particular project.

However, a company's development plans are not finalized until the permit stage (generally 6-8 years after lease issuance). Thus the initial development proposals in the RR & PP may change constantly until the time of actual development. Requiring the RR & PP at such an early stage is pointless because current 211 regulations prevent the approval of the RR & PP until a complete permit application package has been filed, usually 6-8 years after lease issuance (unless the federal lease bond has been determined by the authorized officer to be adequate).

4) Disparate royalties and rentals

Current federal royalty rates are either 12½% or 8% of the selling price depending upon the proposed operation. Consol presently controls approximately 6,200 private surface and/or coal leases throughout the United States.

It is Consol's opinion that private royalty rates range from 3-5% of the selling price for underground leases (approximately 95% of Consol's private underground leases provide for a royalty of 3% of the selling price or less) and range from 5-7% of the selling price for surface leases (approximately 95% of the surface mining leases provide for a royalty rate of 5% or less).

Additionally, federal lease bonus payments are not recoupable future production and are not deductible for income tax purposes. The

The four proceeding elements are found exclusively in federal leases, and such disparities in lease terms lower the value of the federal lease to the potential lessee. Nevertheless, they are not recognized as having a negative value by the BLM when calculating fair market value.

TRACT DELINEATION

There have been occasions when federal tracts proposed to be leased were delineated in such a manner that Maximum Economic Recovery (MER) of the coal was technically impossible; yet when determining fair market value, the BLM assumed MER.

One example of this situation is the tract delineation of the North Horn Mountain Tract (Uinta - S.W. Utah Coal Region) offered for lease in May of 1982. Although industry provided the government with sufficient information regarding the mineable delineation of this tract, the configuration of the tract as offered allowed for no feasible access to the coal. The underground mineable coal seam of this tract outcropped at the northern edge of the property and technical and economical considerations required a drift entry at this point. However, this area was determined to be unsuitable for development by the U.S. Forest Service. As a result, no access was provided to the coal. This inaccessibility completely devalued the tract to industry yet the tract was offered for a minimum bid of $40,000,000. At that time this amount was considered by the government to represent a fair market value. On May 27, 1982 the tract was offered for a lease and not a single bid was submitted, even though a large amount of interest for leasing by industry was shown prior to final tract delineation.

In instances such as this, additional federal coal was required prior to mining in order to allow economical access to the reserve. However, the uncertainty of acquiring such additional acreage presents a risk which affects the value of the original lease offered. In this example, the government failed to address the critical need for access to the reserve; yet, when determining FMV, assumed that Maximum Recovery would be achieved.

READJUSTMENT RISKS

The majority of Consol's federal leases were issued prior to 1976. The royalty rates for those leases were 15¢ to 20¢ per ton for surface mineable coal and were subject to readjustment upon the expiration of the initial term of 20 years. With the enactment of the Federal Coal Leasing Amendments Act (FCLAA), royalties were to be automatically readjusted at the end of the current term to 12½% of the selling price for surface mineable coal, an increase of over 1000% (assuming a selling price of $17/ton).

Although an increase in royalties at readjustment was expected as a result of FCLAA, this tremendous increase was far beyond what we feel is in the spirit of "readjustment".

Different administrations have different views on the policies relating to federal coal leasing and development. Readjustment terms may be used by an administration to encourage or discourage the development of the lease. Changes in administration or administration policies make it difficult for companies to predict what the new readjusted terms will be.

Similarly, other requirements (i.e., Pre-sale Fair Market Value and Maximum Economic Recovery determinations) have been relaxed or tightened under various administrations. As a result, industry must consider the possibility of future statutory and/or regulatory changes that may potentially devalue it's federal leaseholdings when determining the bonus bid amount for a new lease.

CONCLUSION AND RECOMMENDATION

It is unlikely that the Commission can develop a system for determining fair market value which universally is applicable. While many of the conditions associated with the development of a lease are known and quantifiable, there remains a part of the lease evaluation process that is essentially subjective. How bullish is the lessee about future market conditions? Is the mining system to be employed one with which the lessee is familiar? Is the drilling data sufficient to predict changes in coal quality or mining conditions? These questions and others are not readily quantifiable. They represent the risk elements in any project and each company evaluates them differently depending upon management style, management strategies and the personalities of the managers themselves.

The use of comparable sales, discounted cash flow analyses or other such procedures all will be unsatisfactory from time to time. The best measure of fair market value for government leases is vigorous bidding at the lease sales. This represents the best measure of the market's valuation of each tract being offered.

As recent lease sales would indicate, the emphasis of the federal government in the next several years should be on promoting competition for its leases. We believe that competition will be there if the tracts offered by the government are attractive to potential lessees and are not encumbered by too many devaluing requirements. As we mentioned earlier, royalty rates, development requirements and tract delineation all require attention. In addition, we would suggest that the government review the screening process whereby tracts are eliminated from the list of offerings prior to sale. We believe that the screening process considers coal mining as the land use of last resort. Therefore, many tracts which would be attractive to coal operators as potential leases are eliminated before the sale because a competing land use is determined to be of higher value.

Even if such changes were made, there will be instances where only one bid will be received. This is often the case with maintenance or bypass leases. In such cases, Consol recommends that the government consider "negotiated sales" as a method for obtaining fair market value.

Maintenance and bypass leases should be delineated and offered "on application"; that is, a company would apply for a lease on an area that would normally be "bypassed" or that would be necessary to "maintain" an existing operation. Once an area was jointly delineated, the government and interested party would negotiate a "fair" price per acre.

In instances where a new production tract (stand-alone tract) receives one bid, the lease should be awarded to the sole bidder. This single bid (as with maintenance and bypass leasing) represents the maximum "value" that the marketplace attaches to the coal lease and thus the bid should be accepted as it represents fair market value.

APPENDIX 1

The following examples illustrate the sensitivity of the bonus bid amount relative to various pre-sale assumptions that a bidder must make.

CASE 1: Demonstrates how variations in the production level affect the after - royalty net present value of a project.

CASE 2: Demonstrates how the start up date affects the after - royalty net present value of a project.

CASE 3: Demonstrates how mine planning affects the after - royalty net present value of a project.

In each of these three cases that follow, base assumptions were made that were not necessarily reflective of actual conditions. (For example, the selling price of western coals is generally higher than $10 per ton). This was done primarily to simplify calculations.

Although there are many additional assumptions that have an affect on net present value, there examples were chosen as they are representative of the range of assumptions that a bidder is required to address.

CASE 1:

This example illustrates how variations in the production rate affect the after - royalty net present value of a project.

In this example, two companies estimated production at different rates; company "A" estimated production at 2.5 million tons per year for forty years while company "B" estimated production at 5 million tons per year for twenty years. Despite the difference in production rates, cash costs and capital recovery were assumed to be equal for both companies. This could result from different mine plans or mining methods but was purely coincidental in this case. The results therefore reflect how production levels directly affect net present value.

CONCLUSION

Due to the different rates of production, company "A" could bid only $2.15 million dollars while company "B" could bid $4.205 million dollars for the same tract. This is a difference of $1.79 MM or approximately 74%. When royalty and tax payments are included with the bonus bid, the percentage difference in "true value received per ton" is much less (1%).

In general, cash costs and capital recovery per ton should be less for the higher production case (company "B"). If this had been reflected in the economics, the percent difference between the "maximum bonus bid per ton" would be even greater.

CASE 1

	COMPANY "A"	COMPANY "B"
Purchase Lease	Year 0	Year 0
Start Mining	Year 7	Year 7
Production Rate	2.5 MMTPY	5 MMTPY
Mine Life	40 Years	20 Years
Coal Market Price ($/ton)	10.00	10.00
Royalty (@ 12½% of selling price)	- 1.25	- 1.25
Mine Price	8.75	8.75
Cash Costs (Labor, equipment, etc.)	- 6.30	- 6.30
	2.45	2.45
Capital Recovery @ desired rate of return	- 2.10	- 2.10
Before Tax Value ($/ton)	0.35	0.35
After Tax Value ($/ton) - 50% tax	0.175	0.175
Net Present Value of After Tax Value discounted at 10%	$2.415 MM*	$4.205 MM*
Maximum bonus bid per ton ($/ton)	0.024	0.042
Percent Difference	--	74%
NPV (Taxes & Royalty) @ 10% + bonus	$22.080 MM	$38.445 MM
True Value Received per ton leased ($/ton)	0.221	0.385
Total Revenue to Government (not discounted)	$144.915 MM	$146.705 MM

*Company "A" NPV = (0.175 $/ton)(2.5 MMPTY)(P/A 10,40)(P/F 10,6) = $2.415 MM

*Company "B" NPV = (0.175 $/ton)(5.0 MMPTY)(P/A 10,20)(P/F 10,6) = $4.205 MM

CASE 2:

This example illustrates how variations in the start up date affect the after - royalty net present value of a project.

In this example, two companies proposed different start up dates; Company "A" proposed to begin production seven years after lease issuance while Company "B" proposed to begin production five years after lease issuance. All other variables were the same for both companies.

CONCLUSION

Due to the differing start up dates, Company "A" could bid $4.025 while Company "B" could bid $5.088 MM for the same tract. This is a difference of $0.883 MM or approximately 21%. When royalty and tax payments are included with the bonus bid, the percentage difference in value received is much less (1%).

CASE 2

	COMPANY "A"	COMPANY "B"
Purchase Lease	Year 0	Year 0
Start Mining	Year 7	Year 5
Production Rate	5 MMTPY	5 MMTPY
Mine Life	20 Years	20 Years
Coal Market Price ($/ton)	10.00	10.00
Royalty (@ 12½% of selling price)	- 1.25	- 1.25
Mine Price	8.75	8.75
Cash Costs (Labor, equipment, etc.)	- 6.30	- 6.30
	2.45	2.45
Capital Recovery @ desired rate of return	- 2.10	- 2.10
Before Tax Value ($/ton)	0.35	0.35
After Tax Value ($/ton) - 50% tax	0.175	0.175
Net Present Value of After Tax Value discounted at 10%	$4.205 MM*	$5.088 MM*
Maximum bonus bid per ton ($/ton)	0.042	0.051
Percent Difference	--	21%
NPV (Taxes & Royalty) @ 10% + bonus	$38.445 MM	$46.519 MM
True Value Received per ton leased ($/ton)	0.385	0.465
Total Revenue to Government (not discounted)	$146.705 MM	$147.588 MM

*Company "A" NPV = (0.175 $/ton)(5 MMPTY)(P/A 10,20)(P/F 10,6) = $4.205 MM

*Company "B" NPV = (0.175 $/ton)(5.0 MMPTY)(P/A 10,20)(P/F 10,4) = $5.088 MM

CASE 3:

Although many factors may vary, it is assumed for this example that the only variable is the orientation of the federal tract being leased. Two companies have been mining identical tracts of land for twenty years. After two more years of mining they will encounter an 80 acre tract of federal coal over which they have surface rights. The only difference between the cases is the orientation of the tracts (see illustration). Current economics for the mines are as follows:

Coal production	2,000,000 tons per year
Mine life with tract	16 years
Mine life without tract	15 years
Selling price of coal	$12/ton
Existing royalty	$.25/ton
Mining cash cost	$8.35/ton
Return on investment	$3.45/ton

Assumptions:

Cost to shorten pit	$1,200,000/mile
Cost to lengthen pit	$1,200,000/mile
Haulage cost	$.12 per ton mile

CONCLUSION (see Tables 1 & 2)

In the case of Company "A", it would cost more to mine the federal coal because of the high royalty than to bypass it entirely. The difference between the two cases in net present value is $234,162 or $2,927 per acre. Company "A" would make no bid at all; the government would not receive any value. In the case of Company "B", the cost of mining the federal coal is less than the cost of not doing so. The difference between the two options is $24,136 or $302 per acre. Company "B" could afford to bid no more than $302/acre on this tract. The government would realize the bid plus royalty of $3,000,000 for a total of $3,024,136.

ADDITIONAL COST-OPTIONS 1

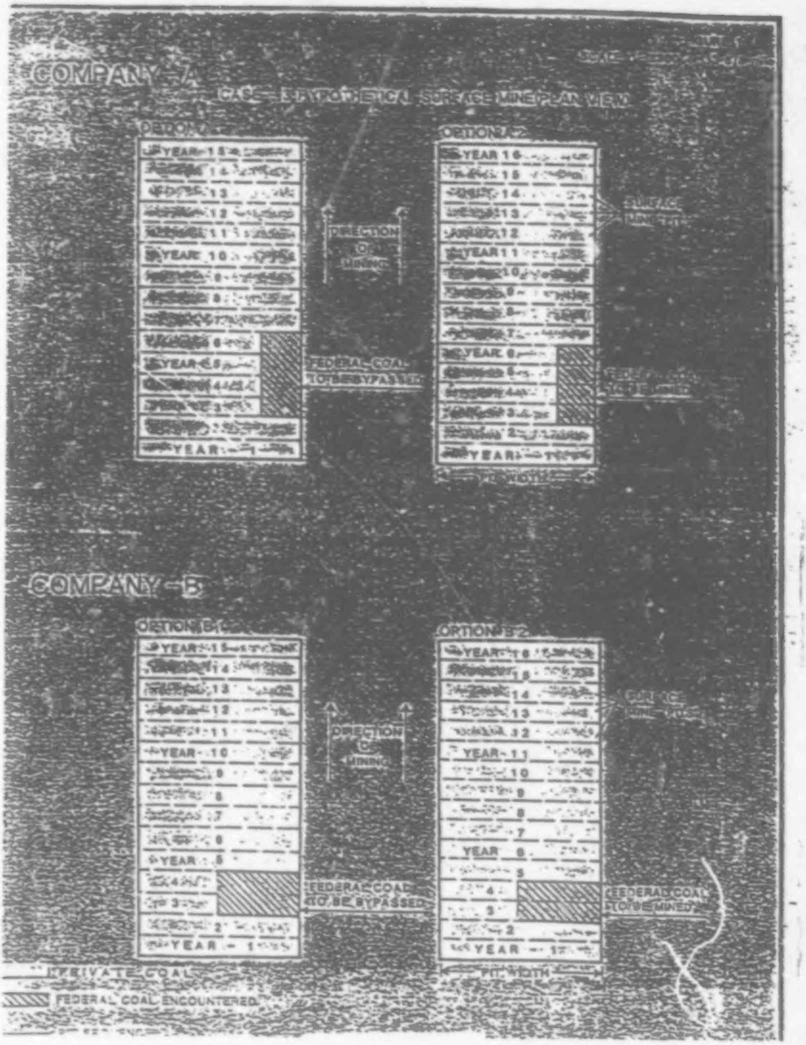
TABLE 1

Cost Item	Cost in $	NPV of Cost @ 10%
Option A1:		
Shorten pit - year 3	300,000	225,394
Extend pit - end of year 6	300,000	169,342
Haulage cost or (savings):		
- year 3	(5,000)	(3,757)
- year 4	(15,000)	(10,245)
- year 5	(25,000)	(15,523)
- year 6	(30,000)	(16,934)
- year 7	(30,000)	(15,395)
- year 8	(30,000)	(13,995)
- year 9	(30,000)	(12,723)
- year 10	(30,000)	(11,565)
- year 11	(30,000)	(10,515)
- year 12	(30,000)	(9,559)
- year 13	(30,000)	(8,690)
- year 14	(30,000)	(7,900)
- year 15	(30,000)	(7,182)
Income lost - year 16	6,800,000	1,479,878
Total NPV		1,730,630
Option A2:		
Royalty - year 3	750,000	563,486
- year 4	750,000	512,260
- year 5	750,000	465,691
- year 6	750,000	423,355
Total NPV		1,964,792

ADDITIONAL COST-OPTIONS 2

TABLE 2

Cost Item	Cost in $	NPV of Cost @ 10%
Option B1:		
Shorten pit - year 3	600,000	450,789
Extend pit - end of year 4	600,000	409,808
Haulage cost or (savings):		
year 3	(15,000)	(11,270)
- year 4	(30,000)	(20,245)
- year 5	(30,000)	(18,628)
- year 6	(30,000)	(16,934)
- year 7	(30,000)	(15,395)
- year 8	(30,000)	(13,995)
- year 9	(30,000)	(12,723)
- year 10	(30,000)	(11,566)
- year 11	(30,000)	(10,515)
- year 12	(30,000)	(9,559)
- year 13	(30,000)	(8,690)
- year 14	(30,000)	(7,900)
- year 15	(30,000)	(7,182)
Income lost - year 16	6,800,000	1,479,878
Total NPV		2,175,628
Option B2:		
Royalty - year 3	1,500,000	1,126,972
- year 4	1,500,000	1,024,520
Total NPV		2,151,492


COMPANY - A
CASE — 3 HYPOTHETICAL SURFACE MINE PLAN VIEW
OPTION A-1
OPTION A-2
YEAR - 15
YEAR - 10
YEAR - 5
YEAR - 1
YEAR 16
YEAR 11
YEAR 6
YEAR - 1
DIRECTION OF MINING
FEDERAL COAL TO BE BYPASSED
SURFACE MINE PIT
FEDERAL COAL TO BE MINED
PIT WIDTH
COMPANY - B
OPTION B-1
OPTION B-2
YEAR - 15
YEAR - 10
YEAR - 5
YEAR - 1
YEAR - 16
YEAR - 11
YEAR 6
YEAR - 1
DIRECTION OF MINING
SURFACE MINE PIT
FEDERAL COAL TO BE BYPASSED
FEDERAL COAL TO BE MINED
PIT WIDTH
PRIVATE COAL
FEDERAL COAL ENCOUNTERED

LAW OFFICES OF
HUGH C. GARNER & ASSOCIATES
A PROFESSIONAL CORPORATION
SUITE 1400
310 SOUTH MAIN STREET
SALT LAKE CITY, UTAH 84101

HUGH C. GARNER
A. JOHN DAVIS
WILLIAM G. [illegible]
JOHN R. [illegible]
THOMAS A. MITCHELL
JOHN A. HARJA
JUDITH S. H. ATHERTON

(801) [illegible]
FAX (801) [illegible]

January 3, 1986

Senator John Warner
Chairman, Subcommittee on National Resources
Development and Production
United States Senate
Washington, D.C. 20510

Dear Senator Warner:

This letter is in response to the questions posed in your letter of November 19, 1985. As I already informed your office, the letter was not received by this office until December 27, 1985. My attached response will be in the order the questions were presented.

My response herein may not be entirely consistent in that I am responding to both House and Senate proposals. However, my basic position remains consistent. Relief from the 1976 Act should be available to all active lessees who have been adversely affected by the readjustment provisions. If parity can be achieved by setting a single effective date for the full royalty increase for all pre-1976 lessees (except for the few which escaped readjustment), with or without phase-in, that would be desirable.

Thank you very much for this opportunity to respond and to provide additional input. If you have additional questions or concerns, please advise.

Very truly yours,

HUGH C. GARNER & ASSOCIATES, P.C.

Hugh C. Garner

Hugh C. Garner

HCG:nr

RESPONSE TO QUESTIONS OF THE NATURAL RESOURCES DEVELOPMENT AND PRODUCTION SUBCOMMITTEE

Submitted by

Hugh C. Garner, Esq. on behalf of
Blackhawk Coal Company and Peter Kiewit & Sons

(1) It is my understanding that Section 7(a) of S.372 to amend the Mineral Lands Leasing Act of 1920 ("1920 Act") would automatically impose a 12.5 percent (8 percent for underground coal) royalty rate on all coal leases issued prior to the Federal Coal Leasing Amendments Act of 1976 ("1976 Act") "upon the effective date of the first readjustment after the date of enactment of the Federal Coal Leasing Amendments Act of 1985" ("1985 Act"). I believe that the legislation now under consideration should make it clear that the readjustment date referred to in S.372 is the readjustment date provided for in the pre-1976 leases (readjustment every 20 years) and not the shorter 10-year period.

The 20-year readjustment provision contained in pre-1976 leases was incorporated from the 1920 Act. It is a contractual provision between the United States and the lessee. As such, I believe it can only be modified upon periodic lease readjustment.

The 1920 Act provided:

> [A]t the end of each twenty-year period succeeding the date of the lease such readjustment of terms and conditions may

> be made as the Secretary of the Interior may determine, *unless otherwise provided by law at the time of the expiration of such periods.*

30 U.S.C.A. §207 (1971) (repealed) (emphasis added).

This was incorporated in pre-1976 leases by a provision such as the following:

> It is mutually understood and agreed that the lessor shall have the right to readjust and fix the royalties payable hereunder and other terms and conditions at the end of 20 years from the date hereof and thereafter at the end of each succeeding 20-year period during the continuance of this lease *unless otherwise provided by law at the time of the expiration of any such period* . . .

The Secretary of the Interior has argued that the lease provision, "unless otherwise provided by law at the expiration of any such period," automatically incorporates provisions from the 1976 Act at the time of readjustment. This argument was last made in *Coastal States Energy Company v. Watt*, Memorandum Opinion C-83-730J (D. Utah, August 2, 1985). The U.S. District Court disagreed. The court stated:

> The 'unless otherwise provided by law' language modifies the right to readjust. In other words, the Secretary has the right to readjust *unless* the law in effect at the time of readjustment has taken that right away. The 'unless otherwise provided by law' language does not incorporate statutes in effect at the time of readjustment.

Id. at 22, 23. (emphasis added).

Since the "unless" proviso of the leases does not automatically incorporate into pre-1976 leases subsequent statutory changes, pre-1976 leases can only be changed upon their periodic readjustment dates. Thus, the original 20-year readjustment periods can only be altered to 10-year readjustment periods at the periodic readjustments.

Existing regulations already provide:

> All leases issued prior to August 4, 1976, shall be subject to readjustment at the end of the current twenty-year period and at the end of each ten-year period thereafter. (Emphasis added). 43 C.F.R. §3451.1(a)(1)(1984)

However, the Secretary still argues to the contrary. A statement to the effect that "pre-1976 leases providing for readjustment every 20 years shall not be affected until readjustment occurs at the end of the 20-year term currently in effect" would clarify the law.

(2) For the reasons stated above (unless Coastal is reversed), legislation which would impose the higher royalty rate on all pre-1976 leases ten years after enactment of clarifying legislation, without regard to the readjustment date in the leases, in order to treat every pre-1976 lessee the same, would be retroactive law and subject to constitutional challenge.

As a practical matter such an approach is not necessary. The legislative history to the 1976 Act demonstrates that of the 533 federal coal leases in existence in 1976, only 59 (11 percent) were then producing coal. H.R. Rep. No. 681, 94th Cong., 1st Sess. 9. Except for a few leases, the latest readjustment date for a pre-1976 lease would be 1996.[1] This would be 10 years after the effective date of the proposed clarifying legislation, assuming it is enacted in 1986.

Ignoring the few pre-1976 leases which escaped post-1976 Act readjustment (and of these, presumably only a very few were active) effective parity for pre-1976 leases can be achieved by clarifying legislation providing:

> For pre-1976 leases which are readjusted after the effective date of the 1976 Act, including those leases readjusted after the effective date of this Act, the royalty rate as determined under 30 U.S.C. §207 (or the rate as determined under 30 U.S.C. §209) would not take effect until 1996, and until such time, the royalty rate under all such leases would be the rate in effect for such leases immediately prior to the effective date of the 1976 Act.

Near parity would be achieved by such a provision. The few that escaped post 1976 readjustment should not present a major problem.

Further, if "phase in" is desired, as opposed to keeping the 1976 royalty rate in effect until 1996, the phase-in could take effect upon the post 1976 readjustment date, with the applicable royalty rate fully in effect by 1996 (except for pre-1976 leases which escaped readjustment). For example, a lease readjusted in 1978 would be phased-in over 18 years; a lease readjusted in 1989 would be phased in over 7 years; and a lease readjusted in 1994 would be phased in over 2 years. This "phase-in" would also achieve near parity by 1996.

---

[1] Several leases which were subject to readjustment after the 1976 Act were not timely readjusted and thus would not be subject to readjustment again until 20 years thereafter. Presumably, though, such readjustment problems were corrected by 1980, and thus all pre-1976 leases would be readjusted by the year 2000.

(3) Our proposal does track generally the provisions of H. R. 1934 now pending before the full House Interior Committee. It is true that it affords special relief to only those lessees who have resisted the Secretary's imposition of the 12.5 percent (8 percent for underground coal) royalty rate. The reason for this could be that those who resisted were actual producers who felt keenly the adverse economic effect. One producer who did resist saw the royalty increase over 2000 percent upon readjustment. The purpose of our proposal, and presumably of H. R. 1934, is to provide relief to those adversely impacted by royalty readjustment following the 1976 Act.

The inactive federal coal lessees which experienced readjustment without protest do not concern me. Such inactive lessees had not made the great capital investments and long term contractual arrangements which are being crippled by the 1976 Act. Further, one of the purposes of the 1976 Act was, and one of the purposes of the 1985 Act is, to terminate old, inactive leases.

The actively producing federal lessees which experienced readjustment and did not protest do concern me. The increased royalty rate would obviously result in increased operating costs. If these are not burdensome to the lessee it is because they are being passed on to the consumer. In the end, consumers are absorbing the increase, in one form or another. And, the consumers did not have the opportunity to protest the lease readjustment.

If it is determined that there are, in fact, active coal lessees which experienced readjustment and did not protest, I believe that those lessees should also be entitled to relief. Section 7(f)(3) of H. R. 1934 could be amended to read:

> (3) EARLIER READJUSTMENTS, -- For an "active" pre-1976 lease readjusted before enactment of the Mineral Lands Leasing Act Amendments of 1985, the royalty rate requirement of subsection (a)(4) shall not take effect until 10 years after such readjustment. "Active" shall be defined to mean leases which have produced coal and paid royalties in 8 of 12 fiscal quarters immediately preceding readjustment (or some other appropriate definition of "active", as dictated by circumstances).
> In the case of coal leases not considered "active", such lessees shall be entitled to the same relief as "active" lessees if the royalty rate is the subject of one or both of the following--
> (a) A protest of objection pending (as of the date of enactment of the Mineral Lands Leasing Act Amendments of 1985) before the Bureau of Land Management of the Interior Board of Land Appeals.
> (b) An action pending (as of such date of enactment) in a United States District Court of Circuit Court of Appeals.

One more point deserves consideration, that being the statutory royalty rate of 12.5 percent (8 percent for underground). I know that such rate was set without consideration for the nature of the coal industry and the disastrous effect of such increase on the industry and consumers. I know that the rate was arbitrarily set (being the historical rate for oil and gas royalties). While it is possible that the royalty reduction provisions of 30 U.S.C. §209 can address this problem (after appropriate guidelines are promulgated - and only heaven knows when that will occur) I believe that if the relief is to come under §209, more statutory direction is necessary. Royalty reduction relief must be available to those lessees whose only other alternative is to cease production, and that is a costly alternative.

American Petroleum Institute
1220 L Street, Northwest
Washington, D.C. 20005
202-682-8140

C. T. Sawyer
Vice President

1985 DEC 18 PM 4: 11

December 18, 1985

Senator John W. Warner
421 Russell Senate Office Building
Washington, DC 20510

Dear Senator Warner:

I received your letter of November 22 addressed to Jack Ware, acknowledging API's statement for the record on changes in federal coal leasing law and passing on questions by Senator McClure to elaborate the hearing record. We are very appreciative of your efforts to expedite action on this issue by holding hearings.

Our principal interest, as you know, continues to be repeal of Section 3 or its modification to sever the link between coal lease performance and oil and gas leasing. We are aware that Senator McClure has, in the Senate Concurrent Resolution, extended the August 1986 compliance date to the "end of the session" pending a more thorough review of the law. A compliance date, whether in August or end of session next year, puts our industry's federal leasing efforts under increasing uncertainty with no Congressional action.

In the meantime, I have set forth below API's answer to Senator McClure's questions:

1. API position on 2(c) amendments

On page 15 of our statement we note the proposed 2(c) amendment but state API has no position on the issue. API's primary interest in coal leasing is the statutory link between federal coal lessees' performance and the right to lease onshore minerals, principally oil and gas. Railroad leasing of federal coal is not of direct concern to API as an oil and gas association and among those members who are interested there is quite a divergence of positions. For those reasons, we do not feel that we can constructively contribute to the 2(c) debate and have therefore taken no position on the issue.

2. Data on Companies Holding Non-Complying Leases

The data cited on pp. 7-8 of our statement is from J. Steven Griles' May 21, 1985 statement as cited in footnote 5. We have not collected information independent of that compiled by the Department of Interior (DOI) on the identity of holders of non-complying leases or the status of these leases. We continue to rely on DOI for this information.

I am enclosing a list of companies engaged in oil and gas operations which are expected by DOI to hold non-complying coal leases on August 4, 1986. We obtained this list from DOI. In our opinion this list understates the Section 3 problem because it is based on the assumption that companies in compliance with the recently issued Section 3 and Logical Mining Unit guidelines will have no Section 3 problem. While we hope this will be the case, DOI action alone does not eliminate the uncertainty for companies with these leases. This uncertainty can be eliminated only by a change in the law. Added to this uncertainty is the prospect of litigation on regulatory decisions under Section 3. Even if these suits are found to be without merit, the time to prosecute them could disrupt onshore oil and gas leasing programs. This could seriously impact this nation's energy program. To avoid this problem and minimize uncertainty, Congress should act promptly to change the law.

If there are additional questions about our statement, please advise me and we will attempt to answer them.

Sincerely,

Enclosure

```
select affil serial state lessee from ncomp sorted by affil serial +
where comptype = o
 affil                        serial        state     lessee
 ---------------------------  ------------  --------  --------------------------
 AMAX                         w0313773      WY        meadowlark farms, inc.
 ASHLAND OIL                  w0150169      WY        ark land co.
 ASHLAND OIL                  w054728       WY        ark land co.
 ASHLAND OIL                  w25406        WY        ark land co.
 BELCO PETROLEUM              w0322794      WY        belco petroleum corp.
 BROKEN HILL                  u0105404      UT        Utah International, Inc.
 BROKEN HILL                  u0115938      UT        Utah International, Inc.
 BROKEN HILL                  u0122579      UT        Utah International, Inc.
 BROKEN HILL                  u0122582      UT        Utah International, Inc.
 BROKEN HILL                  u0122583      UT        Utah International, Inc.
 BROKEN HILL                  u0122584      UT        Utah International, Inc.
 BROKEN HILL                  u0122623      UT        Utah International, Inc.
 BROKEN HILL                  u0122647      UT        Utah International, Inc.
 BROKEN HILL                  u0122649      UT        Utah International, Inc.
 BROKEN HILL                  u0122650      UT        Utah International, Inc.
 BROKEN HILL                  u0122651      UT        Utah International, Inc.
 BROKEN HILL                  u0122652      UT        Utah International, Inc.
 BROKEN HILL                  u0122675      UT        Utah International, Inc.
 BROKEN HILL                  u0124768      UT        Utah International, Inc.
 BROKEN HILL                  u0140770      UT        Utah International, Inc.
 affil                        serial        state     lessee
 ---------------------------  ------------  --------  --------------------------
 BROKEN HILL                  u098774       UT        Utah International, Inc.
 BROKEN HILL                  u098775       UT        Utah International, Inc.
 BROKEN HILL PETROLEU         nm045217      NM        Bank of America Natl T&S
 BROKEN HILL PETROLEU         u0141171      UT        Energy Res. Group, Inc.
 BROKEN HILL PETROLEU         u0141176      UT        Energy Res. Group, Inc.
 BROKEN HILL PETROLEU         u0141177      UT        Energy Res. Group, Inc.
 BROKEN HILL PETROLEU         u0141178      UT        Energy Res. Group, Inc.
 CHAMPLIN/MAPCO               w42554        WY        medicine bow coal co.
 COASTAL STATES               u0147570      UT        Coastal States Energy Co.
 CONOCO                       c093713       CO        consolidation coal co
 CONOCO                       c093714       CO        consolidation coal co
 CONOCO                       c093715       CO        consolidation coal co
 CONOCO                       c093716       CO        consolidation coal co
 CONOCO                       c1546         CO        consolidation coal co
 CONOCO                       c245          CO        consolidation coal co
 CONOCO                       m1589nd       ND        consolidation coal co
 CONOCO                       m37829nd      ND        consolidation coal co
 CONOCO                       m46292        MT        consolidation coal co
 CONOCO                       u0103107      UT        Consolidation Coal Co.
 CONOCO                       u0103109      UT        Consolidation Coal Co.
 affil                        serial        state     lessee
 ---------------------------  ------------  --------  --------------------------
 CONOCO                       u0103129      UT        Consolidation Coal Co.
 CONOCO                       u0105418      UT        Consolidation Coal Co.
 CONOCO                       u0149373      UT        Consolidation Coal Co.
 CONOCO                       u098783       UT        Consolidation Coal Co.
 CONOCO                       u098784       UT        Consolidation Coal Co.
 CONOCO                       u098785       UT        Consolidation Coal Co.
 CONOCO                       u098787       UT        Consolidation Coal Co.
 EASTERN ASSOCIATED           c037766       CO        thompson creek coal&coke
 GULF OIL                     c0105299      CO        gulf oil corp
 GULF OIL                     c0105300      CO        gulf oil corp
 GULF OIL                     w0220516      WY        gulf oil corp
 GULF OIL                     w0258663      WY        gulf oil corp.
 GULF OIL                     w0244513      WY        gulf oil corp.
 GULF OIL                     w056471       WY        gulf oil corp.
 GULF OIL                     [illegible]   [illegible] [illegible]
```

affil	serial	state	lessee
GULF OIL CO	d038365	CO	gulf oil corp
GULF OIL CO.	c0120073	CO	gulf oil corp
GULF OIL CO.	c0120076	CO	gulf oil corp
GULF OIL CO.	c0120077	CO	gulf oil corp
GULF OIL CO.	c0120078	CO	gulf oil corp
GULF OIL CO.	c0120079	CO	gulf oil corp
GULF OIL CO.	c0120080	CO	gulf oil corp
GULF OIL CO.	c0123177	CO	gulf oil corp
GULF OIL CO.	w060274	WY	gulf oil corp.
MAPCO	b025369	WY	big horn coal co.
MAPCO	m061686	MT	peter kiewit sons co
MARATHON	c0125485	CO	us steel corp
MARATHON	c12638	CO	us steel corp
MARATHON	c12639	CO	us steel corp
MARATHON	c1894	CO	us steel corp
MARATHON	c7852	CO	us steel corp
MARATHON	c7853	CO	us steel corp
MARATHON OIL	m3831	MT	us steel corp
MARATHON OIL	m3832	MT	us steel corp
NERCO OIL	b031719	WY	antelope coal co.
NERCO OIL	w0312917	WY	resource development co.
NERCO OIL	w0313559	WY	resource development co.
NERCO OIL	w0322255	WY	antelope coal co.
NERCO OIL	w092140	WY	resource development co.
NERCO OIL	w092141	WY	resource development co.
OXY	c0125515	CO	salt creek mining co
OXY	c0125516	CO	salt creek mining co
TEXACO	w030009	WY	texaco, inc.
TEXACO	w030052	WY	texaco, inc.
TEXACO	w0321120	WY	texaco, inc.
TEXACO	w046349	WY	texaco, inc.
TEXACO	w051959	WY	texaco, inc.
YES	c0114093	CO	peabody coal co
YES	c086654	CO	peabody coal co
YES	c088199	CO	peabody coal co
YES	w0321779	WY	rochelle coal co
YES	w37829	WY	rochelle coal co
-0-	es12847	KY	Leeco, inc.
-0-	nm10921	NM	east. assoc. prop., inc.
-0-	Or12472	OR	Eden Ridge Coal Co.
-0-	Or3520	OR	Pacific Power & Light Co.
-0-	s1062605	UT	Kanawha Hocking Coal&Coke
-0-	u0103130	UT	Consolidation Coal Co.
-0-	u0126916	UT	Utah International, Inc.
-0-	u0147999	UT	Utah International, Inc.
-0-	u0149562	UT	Utah International, Inc.
-0-	u067495	UT	Kanawha Hocking Coal&Coke
-0-	w12793	WY	winton coal co.

United States Senate
COMMITTEE ON
ENERGY AND NATURAL RESOURCES
WASHINGTON, DC 20510

November 22, 1985

Mr. Jack Ware
Washington Representative
American Petroleum Institute
1220 L St., N.W.
Washington, D.C. 20005

Dear Mr. Ware:

Thank you for submitting testimony to be inserted in the hearing record for the recent hearing on coal leasing legislation, held on November 8, 1985. Senator McClure announced at that hearing, that questions would be submitted for some of the witnesses. He also indicated that responses to such questions should be returned to the Subcommittee as expeditiously as possible. Therefore, I would appreciate your prompt response to the attached questions.

Again, I appreciate your testimony. If you have further questions, please call either Pat Sullivan or Bob Terrell of the Subcommittee staff.

Sincerely,

John Warner

John W. Warner
Chairman, Subcommittee on Natural
  Resources Development and Production

JWW/ps/er

QUESTIONS SUBMITTED FOR API BY SENATOR McCLURE

FOR THE RECORD

1. In reading the testimony submitted for the record by API for the November 8, 1985 coal leasing hearing, I notice a conspicuous absence of any comments on my two amendments to Senator Wallop's bill, S. 570, which reform and/or repeal section 2(c) of the MLLA. As you know, my amendments were among those items for which testimony was invited. API's response to the following questions would be appreciated.

    a) Was API's failure to comment on my 2(c) amendments simply a matter of oversight or was it intentional?

    b) Does API wish to take a position on my amendments? If you oppose my amendments, as formulated, does API have any suggestions as to how they might be modified to gain your support?

2. On page 8 of your testimony, it is stated, "Of these 229 non-complying leases, 101 are held by firms with oil and gas interests. Finally DOI estimates that at least 150 oil and gas companies including affiliates may be prevented from obtaining other onshore federal mineral leases after August 4, 1986, if section 3 is left in place and applied."

    a) What and how many gas interests are affected by the 101 non-complying leases held by oil and gas companies?

    b) Could you please supply the names of the 150 oil and gas companies and affiliates?

    c) Of the 150 oil and gas companies including affiliates potentially prevented from obtaining onshore federal mineral leases because of the section 3 prohibition, how many and which companies and affiliates will have their leases come into compliance under section 3 and LMU guidelines issued by the Department of the Interior?

DAVID CHARLES MASSELLI
ATTORNEY AT LAW
422 C STREET, N.E.
WASHINGTON, D.C. 20002

(202) 546-6258

24 January, 1986

The Honorable John W. Warner
Chairman
Subcommittee on Natural Resources
Development and Production
Committee on Energy and Natural Resources
United States Senate
Washington, DC 20510

Dear Senator Warner:

Subsequent to the hearing held on legislation to amend the Mineral Leasing Act, you forwarded a series of questions to the Western Organization of Resource Councils.

Enclosed is the response of the Western Organization of Resource Counsils to those questions. I look forward to working with you and your staff as you continue to address the issues raised by the pending legislative proposals.

Sincerely,

David Charles Masselli
Washington Counsel
Western Organization of
Resource Councils

Response of the Western Organization of Resource Councils To Questions Submitted For the Record

Q. 1. Discussing the potential environmental impacts of coal leasing in various geographical regions can be misleading. Given the size of the major Western Federal coal regions, sound planning may locate acceptable tracts in every region while unsound practices may lead to potential conflicts in any. Most potential environmental conflicts are highly site-sensitive.

However, when WORC does a broad-brush analysis of the impacts of potential coal leasing, our concerns are the following, based on proposals for leasing contained in the most recent round of tract planning and environmental analyses:

Green River - Hamms Fork: In many areas which have been discussed for potential further leasing, there are clearcut conflicts between coal development and wildlife values.

Uintah-Southwest: In the Southern portion of this regions, there are obvious conflicts between coal development and the protection of areas of great scenic beauty, some of which are within the "Golden Circle of Parks" and some, like areas on the Kaiparowits Plateau, which have almost no regulatory or statutory protection.

Northern Powder River: We are quite concerned over the possible impacts on agriculture and lifestyle of development in the Tongue River region of Montana.

San Juan: The potential for conflict with areas of immense archaeological and historic significance in the Chaco Canyon region is obvious.

Fort Union: Potential conflicts with areas of archaeological significance are apparent in the Knife River Flint Quarries.

Q.2. WORC does not oppose the resumption of a responsible Federal coal leasing program. We believe that any such program should be based on the need for production, rather than to meet the goal of allowing the coal industry to stockpile reserves at bargain basement prices, and must guarantee a fair return to the taxpayer.

In light of the current coal market picture, it is our view that any responsible leasing program would be very modest during the next few years. The most cost effective approach to relieving the bulk of near term demand would be to complete the processing of pending coal preference right lease applications.

Q.3. Again, painting with a very broad brush, we are particularly concerned about the potential impacts of existing non-producing leases in the following area:

Southern Utah: Development of any of the huge cluster of nonproducing leases in the Kaiparowits Plateau area would be a disaster.

New Mexico: Leases in the Chaco Canyon region are a problem.

Western Colorado: Leases in the Yampa River basin and the Meeker region pose threats to wildlife and water quality.

Montana: Development of leases in the Bull Mountain area could have significant deleterious impacts.

Q. 4. Yes. The pre-1976 leases were initially granted with a minimum of environmental review. Even though they will be subject to the minimum requirements of such laws as the Surface Mining Act and the Clean Air Act, many of these same leases -- if granted at all today -- would clearly be subject to various stipulations. We believe that a review process should be instituted which would apply to any such leases which survive and go forward to development precisely such stipulations as are routinely applied to new leases.

Q. 5. No. Insofar as we can determine, pre-1976 leases which have not yet produced are not grandfathered from the major laws regulating coal development insofar as they govern the actual mining process. However, because they have not passed through land use planning and the application of unsuitability requirements, many of these leases have the potential to create impacts -- even when in full compliance with applicable laws -- that would not be allowed in a newly issued lease.

It is important to note that while laws such as SMCRA and the Clean Air Act mitigate many potential impacts of coal development, they do not address with any particular efficacy the problems that arise from siting in areas of scenic beauty, nor are they effective in minimizing the socioeconomic impacts of development or resolving some conflicts with wildlife and other values. In these cases, it has been decided that the best strategy for dealing with these risks is simply not to lease coal in areas where they are likely to occur.

Unfortunately, the pre-1976 leases were issued without these protective screens. Development of some of these leases, even in full compliance with the laws on the books, might well result in impacts which are unacceptable. It is one thing to put up with such impacts when such leases have already been developed in accordance with the laws in place at the time and when, in fact, they are producing coal in a timely and diligent fashion. It is quite another to grant special exemptions to the holders of such leases and allow them to create such impacts at an unspecified time in the future.

Q. 6. The simplest, least costly and most effective means to encourage relinquishment of pre-1976 undeveloped leases is to use the current provisions of Section 3 as passed in 1976.

Q. 7. Yes. It is important to recognize that the leases we are talking about here have been held, in almost all cases, for at least fifteen years. Furthermore, they were available for development during the entire period of extraordinary growth in the Western coal market.

The decisions to not develop these leases before the 1986 deadline were not made in the last two or three years when the market stopped its great growth (the "soft state" of the Western coal market has been reflected in a lessened rate of growth, not in any decline), they were made years before. In our analysis of the pre-1976 we have not been able to find a single instance of a company who has proceeded along towards development with the attendant road building, letting of construction contracts and attendant expenses and then drew back at the last moment because of the lack of a near-term market.

To the contrary, most of these pre-1976 leases have lain fallow and basically ignored for years. This is particularly true with respect to the vast reserves held by speculating companies like Consol and Utah International. In testimony before this Committee, executives from these companies made it quite clear that development of these reserves was not on hold until some market upturn, but was clearly 20, 40 even 60 years down the road.

Q. 8. If such legislation were passed, and we do not support this approach, then it would certainly be improved by requiring the revision suggested in the question. In particular, it would be important to require lessees to pay the FCLAA royalty rate.

Q. 9. Our position on the use of advanced royalty payments to extend the 10 year diligent development period has been spelled out in some detail in pages 29-32 of our prepared testimony. The key elements of that position are:

(1) Any such grace period can not apply to pre-FCLAA leases.

(2) Preference right leases can not be covered by such an extension.

(3) The advanced royalty payment on leases already issued must take into account the windfall received by holders of existing leases who made their bids based on a ten year diligence period.

(4) The advanced royalty payments should not be lower than payments made in lieu of continuous operation, otherwise the person who has attempted production will be penalized relative to the party who has never even tried.

Q. 10. We do not support an open ended extension of the diligence period.

Q. 11. We oppose both amendments for the reasons set forth at pages 39 - 43 of our testimony. We do not view the "comprise" amendment as any significant improvement. It merely reduces the potential impact down to the amount of acreage which the railroads actually wish to lease.

As we have pointed out many times during the past several years, the lands which would be affected by a repeal or amendment to Section 2(c) have very different characteristics from other Western lands. The railroad rights of way run through the heart of agricultural lands in the Northern Plains and the rail lines themselves are the locus of small town development in that region.

Because of the existence of Section 2(c), the Department of the Interior has never seriously studied environmental or socioeconomic impacts associated with coal development in the checkerboarded corridors.

Q. 12. We oppose a complete repeal of the logical mining unit continguity requirement, but believe that the current rigid standard should be relaxed. Our preferred approach would be, after examining the current troubling cases, to specify a maximum zone on allowable distances between leases.

We have mentioned our concern about noncontiguous logical mining units being used as a vehicle to circumvent diligent development. We are particularly concerned about allowing LMU treatment for many of the "paired" mines in the Powder River Basin, which are under common control and often supply coal under contract to the same buyer. We are worried that a generous interpretation of the language in H.R. 1934 might allow incorporation of such pairs as Eagle Butte and Belle Ayre (AMAX) or Coal Creek and Black Thunder (ARCO) or Caballo and North Rawhide (Exxon) into logical mining units.

One of the best ways to guard against the inclusion of two otherwise free-standing mines into an LMU for the purposes of getting around diligent development is, of course, the retention of the forty year mineout provision in current law.

Q. 13. WORC opposes elimination of the forty year mine-out requirement.

Q. 14. It is our belief that analyses of "competitive bidding" can not be totally divorced from the question of what threshold bids are allowed. If extraordinarily low thresholds are allowed, as has been recent practice, then the auction may be entered by bidders who are not serious, in the sense that they have no intent of paying anything near fair market value. Such bidders might not be adverse to picking up a tract if it is sufficiently undervalued, but their role in pressing the bidding towards a fair price is minimal. For this reason, we can not endorse the notion that the presence of two bidders always ensures competitive bidding.

Q. 15. We are strongly opposed to the implementation of negotiated sales. We are in agreement with the position taken by former Deputy Undersecretary Stephen P. Quarles before the Linowes Commission when he noted that the Department of the Interior had neither any background or expertise in conducting such sales. Our own suggestion would be that the Department approach the selling of maintenance tracts in two ways:

(1) By developing models which take into account the true value of a tract to the holder of an adjacent tract, rather than by making the ridiculous assumption as is done now, that such a bidder must pay all the costs associated with opening a new mine on the site and must amortize them over just the new tract rather than the combined operation.

(2) By giving more attention to the use of intertract bidding as a method of gauging the value of such tracts.

Q. 16. The Department's appraisals would be dramatically improved if it would (1) devlote more resources to assessing the physical reserves on site, (2) gather greater information on sale transactions and (3) gather actual data on mining costs, rather than using unrealistic models.

Q. 17. WORC has set forth its views on what steps are required pursuant to Berklund during extensive discussions with the Department of the Interior.

Meridian
Minerals Company
A Subsidiary of Burlington Northern Inc.

January 28, 1986

Hon. John W. Warner, Chairman
Subcommittee on Natural Resources
  Development and Production
Committee on Energy and Natural Resources
SD-306 Dirksen Senate Office Building
Washington, D.C.   20510

Re: Responses to Written Questions Pertaining to the November 8, 1985 Hearing on Coal Leasing Legislation

Dear Senator Warner:

I appreciate the opportunity to respond to written questions submitted to me in your letter of November 19, 1985. These questions arise from testimony given by me and other witnesses at the November 8, 1985, hearing before your Subcommittee on proposals to amend various coal-related provisions of the Mineral Lands Leasing Act of 1920.

"Questions for Railroad Affiliates"

"1. What is your response to Mr. Holsten's testimony that railroads would use their alleged transportation monopoly to discriminate in favor of their coal affiliates with respect to rates and conditions of service?"

The concern expressed by Mr. Holsten that a railroad might discriminate in favor of its coal affiliates is not new. It has been raised on numerous previous occasions by other spokesmen for non-railroad affiliated coal companies opposed to repeal or modification of section 2(c). Both the Justice Department and the Linowes Commission gave careful consideration to and rejected the premise that a railroad would accord preferential, discriminatory treatment to its coal affiliate. The Justice Department first reached this conclusion in its exhaustive consideration of section 2(c) issues in the Antitrust Division's 1980 Report to the Congress on Competition in the Coal Industry. This position was reasserted after the enactment of the Staggers Act in testimony by Assistant Attorney General William F. Baxter before the Linowes Commission in 1983. The Linowes Commission reached the same conclusion in its 1984 report to the Congress.

Having found the lack of any real basis for concern about possible discriminatory action by a railroad in favor of its affiliate, both the Justice Department and the Linowes Commission recommended repeal of section 2(c). These recommendations joined those of the Public Land Law Review Commission and the last five

5613 DTC Parkway • Englewood, Colorado 80111 • 303 694-4100

Administrations. To date, no government or independent study has concluded such preferential treatment is likely and all government agencies and independent panels which have studied the issue have uniformly supported section 2(c)'s repeal. Were there to be a realistic possibility that such discrimination might occur, it seems clear that at least one expert government agency or independent entity would have raised alarm by now. None has done so.

Mr. Holsten's professed concern over railroad discrimination in favor of its coal affiliate, I am told, simply is not a real world fear. The interest of a railroad is to handle the most profitable coal shipments regardless of the producers' identities; market dynamics rather than the identities or affiliations of producers drive a railroad's pricing and marketing activities. For example, because of the potential for larger revenues a railroad would have a greater economic incentive to handle a long-haul shipment or a single-line shipment than a short-haul or a joint-line shipment. In order to make his case for potential discriminatory conduct, Mr. Holsten appears to assume implicitly that in all situations a railroad faces identical bidding conditions as between its coal affiliate and a non-railroad affiliated producer when in fact this would rarely, if ever, occur. Without such an occurrence, the railroad will never have sufficient incentive to discriminate.

Moreover, Mr. Holsten's assumption that railroads enjoy a transportation "monopoly" ignores market realities. The market for coal consumption today is highly competitive. Utilities will typically solicit bids from a variety of sources, many of which are served by different railroads. Utilities also increasingly rely on spot purchases, the wheeling of power, and cogeneration to meet their generation needs. In those circumstances, a railroad which ignores the market and fails to make the lowest possible transportation bids for all potential coal producer customers runs a substantial risk that it will lose far more transportation business than it gains. Rational railroads do not behave this way in the real world.

Finally, I would note that if Mr. Holsten's logic is followed, the railroads already face situations in which they would wish to discriminate in favor of their coal affiliates even without repeal of section 2(c) and in the absence of any leasing of federal coal to the railroads' coal affiliates. These situations exist wherever a railroad serves two non-railroad affiliated producers one of which is mining checkerboard coal leased to it by the railroad or its coal affiliate and the other is mining outside the checkerboard. According to Mr. Holsten's theory, the railroad would wish to discriminate in favor of the producer mining railroad-owned coal because service to that producer would provide two revenue streams -- transportation rates and royalties -- instead of one -- transportation rates only. Certainly, the BN Railroad and other land grant railroads have on numerous occasions quoted transportation bids and provided service to non-railroad affiliated coal producers which are located both inside and outside the checkerboard and which are competing for the same markets. Yet, I know of no instance when a non-railroad affiliated producer which has a mine located outside the checkerboard has alleged that a railroad has made disciminatory transportation bids for, or provided discriminatory service to, a competing producer which has its mine on railroad-owned coal in the checkerboard. Such discriminatory activites have not occurred to date and would not occur in the future were section 2(c) to be repealed.

"2. What is your response to Mr. Holsten's testimony (page 8) that 'even assuming comparable rates are quoted by the railroad, what assurance is there that there would not be an unfair allocation between the quoted freight rate and the affiliate's mine price so that most of the railroad's total profit for the two functions, mining and transportation, would be allocated to the freight rate'?"

If I understand this question correctly, it relates to the potential for the railroad and its coal affiliate to effect a perfect vertical price squeeze. That is, why wouldn't the railroad quote equal, but artifically high, rates to its coal affiliate and to non-railroad affiliated producers thereby enabling the coal affiliate to price its coal f.o.b. mine at cost. Again, this concern of Mr. Holsten ignores market realities in that it assumes perfect knowledge by the railroad and the coal affiliate of the f.o.b. mine prices quoted by other producers and transportation bids offered by other railroads or other modes. In fact, railroads and their affiliates do not possess that knowledge, without which they cannot effect a price squeeze. Moreover, utilities are in a position to ascertain whether a railroad and a coal affiliate are engaging in such behavior by comparing alternative coal prices and transportation offers. Any attempt to work a vertical price squeeze raises obvious legal issues and the threat of litigation by utilities and competing producers. A threat, incidentally, which would be enhanced by the virtually automatic disclosure provisions of Senator McClure's Amendment No. 801.

Even were I able to command the necessary information and avoid any threat of litigation in order to participate in the pricing scenario proferred by Mr. Holsten, I cannot imagine a circumstance in which I would feel free to take such an action. As President of Meridian Minerals Company, my job is to make Meridian, not its railroad affiliate, as profitable as possible. I would simply not engage in any scheme that would have me put my company's capital at risk to purchase a federal lease, open a mine, and then sell the coal at or below cost when Meridian can receive a better and risk-free return by simply leasing its coal to other producers.

"3. With respect to your discussions with your industry opponents to modification of 2(c), Mr. Holsten testified (page 9) that 'the industry group that met this summer did discuss our transportation concerns but the remedies offered to avoid the potential of discriminatory ratemaking were all after the fact, after the business had been awarded, and hence of little value to a commercial producer who had already lost the business to a railroad's mining affiliate.' Please comment on that analysis."

The concerns most vocally expressed by non-railroad affiliated producers at meetings last summer related not to after-the-fact remedies but to the professed inability to learn whether railroads and their coal affiliates engaged in discriminatory conduct. The three railroad coal affiliates offered a proposal modelled after the agricultural commodities provision of the Interstate Commerce Act (49 U.S.C. 10713(a)(2)(B)) which established a procedure by which the ICC could disclose transportation contracts to shippers of agricultural commodities which allege that the railroad is engaging in a discriminatory or destructive competitive practice. This offer was regarded as inadequate by the non-railroad affiliated companies. The three infirmities in this proposal most frequently cited by the non-railroad affiliated companies were: (1) the locus of the information required to determine whether disciminatory conduct has occurred is the ICC, a forum which the non-railroad affiliated producers believe is inhospitable to their interests; (2) the ICC would disclose only the transportation contract but, to determine discriminatory conduct, a non-railroad affiliated company might also need disclosure of the railroad coal affiliate's coal supply contract and coal supply bid and the railroad's bids for hauling competing, non-railroad affiliated companies' coal; and (3), in any case, the ICC would not disclose the transportation contract unless the complainant could make a showing of discriminatory conduct which he could not make without the contract in hand.

Amendment No. 801 removes entirely each of these alleged roadblocks to detection of any possible discriminatory behavior. It takes the disclosure function from the ICC and places it in the Interior Department -- an agency which is generally regarded as more sympathetic to coal producers' concerns, requires disclosure of the supply contract and all supply and transportation bids as well as the transportation contract, and makes disclosure almost automatic by mandating it whenever all provisions in the transportation contract and the railroad's bid to haul the affiliate's coal are not identical in all material respects to the railroad's bids to haul competitors' coal. Only now that Amendment No. 801 has been introduced and previous concerns have been addressed are we hearing so much about this fourth concern over after-the-fact remedies.

Although the absence of before-the-fact remedies was not raised as a significant issue in last summer's meetings, Amendment No. 801 does address the issue by prohibiting the railroad and utility from making the transportation contract final until after disclosure occurs, thus permitting a coal producer which believes it has been discriminated against to seek a preliminary injunction barring contract performance. This apparently is not enough for the non-railroad affiliated coal companies. They are asking in effect either to see a railroad coal affiliate's coal supply bid while they are bidding for the same contract and to sit at the supply contract negotiating table with the affiliate and the utility if the affiliate's bid is selected, or to delay the effective date of a coal affiliate's supply contract and a railroad's transportation contract for a lengthy period of time. No coal company could compete for business, and no utility would wish to contract, under such circumstances.

Contrary to the impression Mr. Holsten sought to leave with the Subcommittee in his testimony, after-the-fact remedies are the rule rather than the exception in most areas of commercial litigation and there is no reason to afford coal producers the highly unusual equitable remedy of broad injunctive relief by legislative fiat. The potential for treble damages or other after-the-fact remedies provides powerful disincentives to railroads and their coal affiliates to behave improperly and would be fully effective deterrents to such conduct. Conversely, any before-the-fact "remedy" would be cumbersome and unworkable to administer, would place railroad coal affiliates in untenable marketing positions, and would create a substantial potential for abuse by competing non-railroad affiliated producers.

"4. Please comment on Mr. Holsten's testimony (page 12) that 'under the Interstate Commerce Act rate discrimination against a coal shipper is not illegal when the traffic is covered by a transportation contract'."

Mr. Holsten's statement that contract rate discrimination under the Interstate Commerce Act is not illegal is incorrect. While a railroad is not prohibited under the Act from entering into different contracts for much of its traffic, under the agricultural shippers provision (49 U.S.C. 10713(d)(2)(B)) contracts for the transportation of agricultural commodities are subject to attack as discriminatory or constituting a destructive competitive practice. As I stated in my answer to question 3 above, the three railroad coal affiliates offered to support an amendment to section 2(c) which would accord identical treatment to coal transportation contracts whenever a railroad has contracted to transport federal coal leased to its coal affiliate, but the non-railroad affiliated companies dismissed this option. I remain prepared to support such a provision in lieu of the disclosure provision in Amendment No. 801 (if that is the Committee's preference), so long as the provision is written in a manner that would not raise jurisdictional questions which could endanger the legislation's chances for enactment.

However, even if language comparable to the agricultural commodities provision of the Interstate Commerce Act were not extended to the coal traffic at issue, the Staggers Act did not purport to insulate transportation contracts from challenge under other applicable statutes or common law. Accordingly, to the extent discrimination is otherwise illegal, injured coal producers are not without remedies. Conversely, non-railroad affiliated coal producers should not be afforded an array of remedies not generally available to other businesses in commercial settings.

"5. What is your response to Mr. Holsten's suggestion (page 14) that, if section 2(c) is repealed, the present exemption of railroads from the prohibitions of unfair trade practices under the Federal Trade Commission Act would have to be re-examined?"

Mr. Holsten is being particularly disingenuous here. He should know that there is simply no nexus between the railroads' exemption from the Federal Trade Commission Act and section 2(c). The Federal Trade Commission Act was enacted six years before section 2(c) and it exempted railroads not because section 2(c) was on the statute books and could be relied upon as a substitute to FTC enforcement but because railroad regulation had already been assigned to the Interstate Commerce Commission. Accordingly, repeal of section 2(c) would not alter the underlying reason for the exemption or otherwise release railroads from the constraints of the antitrust and other applicable laws. We do not believe that the repeal of section 2(c) requires any further tinkering with other statutes because the provisions of Amendment No. 801, together with existing law, provide ample safeguards which fully address any legitimate concerns that coal producers may have.

"6. What is the significance of the fact, pointed out by Mr. Holsten in his testimony (page 16), that only 2 of the 5 members of the Linowes Commission recommended repeal of section 2(c)?"

I am quite surprised Mr. Holsten raised this issue as it applies equally to the legislative relief sought by Mr. Holsten's company and the other non-railroad affiliated producers. They urgently seek repeal or modification of section 3 of the Federal Coal Leasing Amendments Act of 1976 and yet the Linowes Commission supported a change in section 3 by "only" the same 2-0 vote.

Fortunately for both Mr. Holsten and I, the number of Commission members voting for repeal of sections 2(c) and 3 has very little significance. In both votes, the same three members recused themselves because of potential conflicts of interest. The vote remains unanimous in favor of repeal among those Commission members who could view the two sections dispassionately; and *no* commission member voted against repeal. The Linowes Commission report strongly advocates favorable action on both sections 3 and 2(c).

Mr. Holsten also conveniently fails to note that the Linowes Commission recommendation is *only* the most recent of a series of section 2(c) repeal recommendations. The last five administrations, the Antitrust Division of Justice, and a predecessor blue-ribbon panel -- the Public Land Law Review Commission -- have all advocated repeal. In light of these consistent calls for section 2(c)'s repeal, it is not surprising that the Linowes Commission would also vote without dissent in favor of section 2(c)'s repeal. Instead, if anything, the Linowes Commission's identical 2-0 vote on section 3 repeal is the more surprising given the lack of analysis comparable to that undertaken on section 2(c), the absence of any similar history of expert judgments on the need for section 3 repeal, and the high level of controversy concerning the wisdom of section 3 repeal.

"7. What is your response to Mr. Holsten's suggested 'resolution of the section 2(c) problem' at page 17 of his testimony and his recommendation that any action on 2(c) 'should proceed spearately from the consideration of needed amendments to Section 3 and 7' (page 18)?"

I do not believe Mr. Holsten has offered a constructive proposal. I am discouraged that it has taken the non-railroad affiliated coal producers almost 10 months to respond to a full-fledged compromise proposal prepared for their consideration by the railroad coal affiliates under the auspices of the American Mining Congress. Evidently, it took the pressure of potential embarrassment before your Subcommittee to motivate them. And it is clear that they have done only as much as is necessary to be able to say they have responded.

Their response would ignore the recommendations of the Public Land Law Review Commission, the Linowes Commission, and the last five Administrations by continuing to freeze into law a categorical prohibition on railroad coal affiliates' ability to lease where their own coal deposits are -- the checkerboards. I am sure Mr. Holsten and those he speaks for would not stand for a similar prohibition on any coal company's ability to lease federal coal wherever it already had rights to adjacent private coal. Mr. Holsten also wishes to enshrine in law his own theory that railroads enjoy "monopoly power over transportation" -- a theory rejected by the Antitrust Division of Justice in its 1980 report. If a railroad enjoyed such a position, appropriate action could be taken under existing law, including the Justice Department anti-trust review of federal coal lease issuance pursuant to section 15 of the Federal Coal Leasing Amendments Act of 1976.

I do not believe the amendments to section 2(c) and to sections 3 and 7 should proceed separately. All three sections are found in the coal leasing provisions of the Mineral Leasing Act of 1920. All three inhibit the leasing and management of federal coal by preventing classes of companies from bidding on or holding federal coal. The reasons for modifying or repealing the three provisions offered by the railroad coal affiliates and the non-railroad affiliated companies, and confirmed by the Linowes Commission, are identical: the three sections unfairly discriminate against certain competitors, they frustrate coal production and competition, they are too punitive, they are redundant to other statutory provisions that are more equitable and less draconian, and they are no longer needed to serve the purpose for which they were written. In the effort to modify or repeal sections 3 and 7, the non-railroad affiliated companies have argued conditions have changed dramatically since 1976 when these provisions were enacted. Conditions, of course, have altered even more in the 65 years since section 2(c) was passed.

Finally, Mr. Holsten suggests the compelling reason for addressing section 2(c) and sections 3 and 7 separately is that section 3 is an urgent matter. If his reasoning is followed, consideration of section 7 should also be undertaken separately from section 3 since it too does not share the urgency of section 3. In fact, section 7 is the only provision which does not require prompt attention. Section 2(c) needs to be addressed as quickly as section 3, if not sooner. The effective date of section 3 is December 31, 1986. Until that time potential violators of section 3 are still free to bid on federal coal leases. However, section 2(c) now bars railroad coal affiliates from bidding on federal coal leases. Since Interior may hold federal coal lease sales before December 31, 1986, section 2(c) should have priority even over section 3 as a matter for immediate attention by the Congress. As a practical matter, however, I recognize that Congress will not have the luxury of addressing section 2(c) prior to section 3 if both sections are to be modified in a timely fashion. Accordingly, I firmly believe that at least both sections 3 and 2(c) (if not section 7 as well) should be addressed in the same legislation.

"8. Please comment on Mr. Holsten's testimony that Lee Ranch Mine was 'put into operation knowing 2(c) is in effect'."

I assume Mr. Zitting, President of SF Minerals Corporation, the owner and operator of the Lee Ranch Mine, will submit a written answer to this question.

"9. Mr. Holsten suggests in his testimony that SF Minerals has not been leasing its coal, but waiting for the repeal of 2(c). How much coal does SF Minerals control? Of this, how much is under lease or committed to a purchaser?"

Please refer to my answer to question 8.

"10. During the question period after your testimony, Senator Ford read an excerpt from testimony before the Linowes Commission by Donald Young, Director of the ICC's Bureau of Accounts. In that excerpt Mr. Young stated: 'Except in the case of agricultural commodities or challenges by courts, the Commission may not disapprove a contract because a rate unreasonably discriminates against some other shipper. Therefore, it is possible that a rail carrier could negotiate a contract rate with its mining subsidiary which was significantly lower than the rates charged to other coal shippers.' Given Senator Ford's concern and Mr. Young's statement, would you be willing to consider a statutory requirement that a procedure and remedy identical to the agricultural commodities procedure and remedy shall be available to competing coal producers whenever you hold a federal coal lease within your railroad affiliate's exclusive service area?"

Please refer to my answers to questions 3 and 4 above in which I state that I would be prepared to support an amendment modelled on the agricultural commodities provision referred to by Mr. Young.

"11. In Mr. Holsten's testimony he said he had requested an opportunity to discuss 'transportation and . . . antitrust' issues concerning section 2(c) with your holding company or railroad affiliate. He added that 'to date, any request for such a meeting has been denied us'. Please confirm whether such a request was made to your holding company or railroad affiliate and describe both the nature of the request and any response made by the parent or affiliate."

I understand that Mr. Holsten requested on short notice a meeting with the Chairman of our holding company on a date when our Chairman was out of town. Mr. Holsten did not ask to meet with anyone else in the holding company and has not requested or suggested any further meeting.

I also understand that Mr. Holsten may have spoken briefly to the President of BN Railroad during the course of a Coal Transport Association meeting. This quick discussion focussed primarily on section 2(c) leasing issues and no further meeting to discuss transportation and antitrust issues associated with section 2(c) was suggested or requested. (Please refer also to my answer to Senator Bumpers' question 2 below.)

It should also be noted that Burlington Northern Railroad has been meeting with its coal producer and user customers in an ongoing effort to promote the use of coal. BN Railroad, as much as any coal producer or user in its territory, depends for its survival on maintaining or increasing coal use; and for this reason BN Railroad is fully committed to working with these companies to maintain a healthy coal industry.

"Questions Submitted by Senator Bumpers"

"1. Why should railroads and their mining affiliates be given the right to lease federal coal when they have opposed development of alternative forms of transportation, such as coal slurry pipelines?"

I understand that Burlington Northern Railroad and BNI are not opposed to development of alternative forms of transportation. Indeed, BNI itself has recently established a trucking subsidiary. Rather, BN Railroad and BNI are strongly opposed to legislation which would grant coal slurry lines special privileges which are denied to competing forms of transportation -- particularly the right of federal eminent domain and the right to operate as a private as opposed to common carrier. For example, legislation in the last Congress sought to extend the right of federal eminent domain to slurry lines. Had that legislation passed, those lines would have been able to condemn the property of private landowners and operate as private carriers, serving only a few large selected customers. Common carriers, such as the railroads, are obligated to serve the entire shipping public, moving goods to anyone who requests the service. Private carriers, on the other hand, can select just those customers they wish to serve. Condemnation rights are properly reserved for common carriers because they serve the entire public, not just a few large shippers offering the most profitable business.

I also understand that the BN Railroad and BNI are very concerned about any change in current legislation -- on either the state or federal level -- which would affect the use of water for agriculture, or would harm agricultural development in the states. Coal slurry pipelines use a tremendous volume of water (roughly a ton of water to move a ton of coal). Water should only be used for coal slurry pipelines after all agricultural needs have been met.

I am told BNI has no plans to build a coal slurry pipeline. Nor, I am assured, is BNI interested in efforts to block the building of coal slurry pipelines simply because they are a competing mode of transportation. However, if the Railroad is to compete against coal slurry pipelines for coal-hauling traffic, it expects to be able to compete on equal terms, playing with the same set of rules.

"2. I understand that the independent coal companies and the railroad mining affiliates have been working together towards a compromise on Section 2(c) leasing provisions. It is also my understanding that requests made by the coal companies to meet with management of the railroad holding companies for discussions of transportation issues have been denied.

Is this correct?

If so, why were these requests denied?"

No requests for meetings have been denied. (Please refer to my answer to question 11 above.) The BN Railroad has assured me that they will meet at any convenient time with representatives of coal companies, many of which are shippers with the Railroad. If it would also be helpful, the holding company has suggested it will meet with the holding companies of the coal companies.

"3. Please provide a statement on the positions of Union Pacific, Burlington Northern and Atchison, Topeka and Santa Fe railroads on coal slurry pipelines. Specifically, would they favor the grant of Federal eminent domain rights across rights-or-way to slurry pipelines?"

Please refer to my answer to Senator Bumpers' question 1 above.

"Questions for All Witnesses on Panel I"

"1. As you know, Senator McClure has introduced two amendments pertaining to Section 2(c) of the Mineral Leasing Act. One amendment would repeal that provision. The other apparently represents an effort to reach a compromise position on the issue. Could you support both amendments?"

I could support either amendment. Of course, I would prefer outright repeal, but I am presently supporting the compromise amendment (Amendment No. 801). I advocate the compromise even though it continues to discriminate against railroad coal affiliates. I do so because I am determined to do all that I can to silence those who would attempt to characterize any amendment addressing section 2(c) as a "killer amendment" which would endanger the coal leasing legislation. Amendment No. 801 responds to all the reasons originally given by the non-railroad affiliated coal companies for opposing repeal of section 2(c). (Please refer to my answer to the first question 3 above.) I also believe it is a proposal which reflects the present intentions of the Congress. Just as the non-railroad affiliated coal companies might prefer outright repeal of section 3, they know that the Congress is similarly likely to craft a compromise which addresses concerns expressed by opponents of repeal of that provision. Both groups -- section 2(c) and section 3 repeal proponents -- seek the same objective: compromise legislation that is capable of passage.

"2. Do you think that complete repeal of Section 2(c) would have anti-competitive effects?"

On the contrary, I believe repeal of section 2(c) would foster, not inhibit, competition. The agency most expert in matters of competition, the Antitrust Division of Justice, emphatically answered this question in its 1980 Report on Competition in the Coal Industry:

> [L]easing to railroads can also be competitively beneficial by allowing additional competitors to enter the market . . . Plainly, whatever the merits of a general prohibition on leasing to railroads in 1920, the broad sweep of Section 2(c) is now an impediment to rather than a bulkwark (sic) of competition.

In the report's next sentence and in response to that conclusion, the Justice Department recommended outright repeal of section 2(c). More recently, the Linowes Commission reached the same conclusion that section 2(c) repeal would not have an anticompetitive result. These experts have given this question the most detailed study and have no axes to grind. I am delighted to defer to their findings.

"3. Do you think we could alleviate concerns about these anti-competitive effects in the area of coal transportation by moving forward with coal slurry legislation?

What are your views on coal slurry?"

My views on coal slurry were presented in my answer to Mr. Bumper's question 1 above. I do not believe that Mr. Holsten's expressed concerns about anticompetitive behavior if section 2(c) is repealed can be alleviated by enactment of coal slurry legislation. This is simply mixing apples and oranges. I admit that section 2(c) and coal slurry may be linked legislatively because the same Congressional committees have jurisdiction over both issues and because opponents of section 2(c) repeal continue to raise the coal slurry issue in the hope of dissuading section 2(c) repeal proponents from continuing their legislative effort. There is, however, scant substantive reason to link the two subjects -- particularly over the anticompetitive issue. If the scenarios Mr. Holsten describes for potential discriminatory conduct by the railroad and its coal affiliate are at all possible, they remain possible whether or not slurry pipelines are constructed. For the vast majority of coal hauls, the railroad would still be the likely carrier both for the affiliate's coal and the coal of the non-railroad affiliated competitor. Further, if the railroad has sufficient incentive to discriminate in favor of its affiliate's coal it could, and presumably would be compelled to, do so even in competition with a pipeline's transportation bid.

The apples and oranges analogy raises an even more fundamental difference between section 2(c) legislation and slurry legislation. Section 2(c) presently prohibits coal leasing by railroads; on the other hand, existing law does not prohibit the construction and operation of coal slurry pipelines. Indeed one has been built and is currently operating, and another (ETSI) has been sited without the necessity of legislation to remove any federal prohibition. Since western courts have ruled unanimously that railroads cannot block construction of slurry lines, the motives of advocates of federal legislation providing slurry lines with extraordinary power of eminent domain would seem to be to take the property of landowners who are balking and to obtain preemption of western water.

"4. Senator McClure's Amendment No. 801 provides that railroads or affiliated companies leasing federal coal must comply with certain conditions (such as cooperative leasing and sharing of exploration data) only if the Secretary of the Interior finds that competition for the federal lease would be 'substantially enhanced thereby.' What criteria do you think the Secretary should apply in making the determination that competition would be 'substantially enhanced?'

Can you think of circumstances under which competition would not be substantialy enhanced by the sharing of data or the guarantee of cooperative leasing?"

I believe that the competition enhancement wording addresses situations similar to those found in the exceptions to cooperative leasing in Amendment No. 801. For example, in its 1980 Competition in the Coal Industry report, the Justice Department found that less than one-third ownership of a joint venture involving a federal lease would not raise anticompetitive issues or be violative of section 2(c). The Amendment provides an exception for this situation. I also do not think competition would be enhanced in instances where the federal government owns and is offering for lease only a small amount of coal adjacent to a railroad affiliate's coal. In this situation, the tail should not wag the dog. Throughout the West, coal producers have situations where they have assembled most of the coal properties or surface owner consents necessary to achieve a minable unit and need only a small amount of adjacent federal coal; neither they nor we should be required to cooperatively lease the private holdings for a small amount of federal coal of no interest to competitors. In some places in our "checkerboard", neither my company nor the federal government owns substantial coal resources. Instead the bulk of the coal is in other, private ownership and is often controlled by our competitors. Here competition enhancement would be so insubstantial at best it could not justify the substantially increased administrative costs of mounting a cooperative lease sale. Finally, as members of the Subcommittee recognized in questions during the hearing, it would be patently unfair for the government to require a railroad coal affiliate to offer its operating mine for lease in a cooperative lease sale to obtain a bypass or maintenance lease for that mine. If the exceptions survive markup, perhaps the competition enhancement language can be tightened, or the report can direct the Interior Department to write regulations, to limit the Secretary's discretion to forego cooperative leasing only in those situations where the Department determines no other company can reasonably be expected to bid on the coal. (Please also refer to my answer to question 5 below.)

"5. Amendment No. 801 employs the term 'potential mining unit.' What criteria do you think the Secretary of the Interior should apply in designating 'potential mining units?'"

Should there be limitations on the size of the 'potential mining units'? If so, what?"

I expect that the "potential mining units" would be designated by the regional coal teams. Regional coal teams in effect already undertake this task in delineating lease tracts. The Linowes Commission has urged that the Department delineate lease tracts in a manner that will make them most competitive --

attract the most competitors. To accomplish this purpose, the tract delineators have to consider various potential mining units encompassing the leaseable coal. I believe that the Linowes Commission recommendation should apply equally to the delineation of lease tracts which will be cooperatively leased and that competition enhancement should be the principal criterion for drawing the potential mining units for cooperative leasing. If this is done, then the no-substantial-competition-enhancement exception to cooperative leasing in Amendment No. 801 will be employed seldom, if at all. (Please see my answer to the previous question.) Obviously, other criteria are necessary to ensure that a lease tract is economic, that the most favorable Maximum Economic Recovery will be obtained, and that obvious environmental or land management problems are avoided. I also believe the potential mining unit decision should be made only after full opportunity for public comment so as to ensure that all potential bidders for the federal coal can participate in the unit and tract delineation process.

I am generally opposed to arbitrary size limitations of any kind. However, I have already acquiesced in Amendment No. 801's overall acreage limitation on a railroad coal affiliate's holdings of federal leases within the checkerboard. The purpose of that provision is to assure competitors that modification of section 2(c) would not permit a railroad coal affiliate to dominate checkerboard coal leasing. Therefore, if an overall limitation on the size of potential mining units is deemed necessary for the same purpose and is not unduly restrictive, I would consider supporting it.

I hope you will find these answers to be responsive. I am happy to elaborate further on any point you may wish. Thank you for the opportunity to appear before your Subcommittee.

Sincerely yours,

GW Thompson

G.W. Thompson

ROCKY MOUNTAIN
ENERGY

A Subsidiary of
Union Pacific Corporation

James C. Wilson
President

January 27, 1986

Honorable John W. Warner, Chairman
Subcommittee on Natural Resources
Development and Production
306 Senate Dirksen Office Building
Washington, D. C. 20510

Dear Mr. Chairman:

I am pleased to attach responses to the questions posed by you and other members of the Subcommittee in connection with your hearing of November 8, 1985, on amendments to the federal coal leasing program.

A careful reading of my responses to the first eleven questions will, I trust, portray to you a realistic picture of the process that led the rail affiliated coal companies to propose modifications of section 2(c), which proposals have been essentially incorporated in Amendment Number 801.

I would draw your specific attention to three themes:

1. Although the three Western rail affiliated coal companies have never believed that outright repeal of section 2(c) would lead to anything but enhanced competition--both in the competition for federal coal leases and in the competition for coal customers in the marketplace--we have nevertheless shown infinite patience and inordinate flexibility in attempting to meet the perceived concerns of our coal competitors. Each of our proposals has been specific and in some cases fine tuned well beyond the original form in response to mostly informal reactions by our competitors. Each proposal has, therefore, become for any reasonable and objective observer, a satisfactory basis for legislative action.

2. At no time have members of the coal industry establishment for whom Mr. Holsten testified ever made a concrete proposal on modifications of 2(c) that would be satisfactory to them. Through months of dealing first somewhat formally with a coal industry committee and then informally with an ad hoc group

10 Longs Peak Drive
Box 2000
Broomfield, Colorado 80020
303/469-8844

of coal industry leaders with Mr. Holsten as their spokesman, we have received only two kinds of response: one, reactions to our proposals, some of which were constructive, but others of which were whimpering expressions of a stubborn resistance to any form of compromise; the other, a process of escalating the asking price until, when all pertinent and reasonable requests had been met with pertinent and reasonable responses, the Staggers Act became their stated price. Whether or not the Staggers Act is to be modified is a matter for an entirely different forum to address, not a matter to be traded against perfectly reasonable modifications of section 2(c).

3. Time and again, recommendations for outright repeal of section 2(c) have been made by respected councils and authorities, all in the name of enhanced competition and ultimate benefit for the final consumer. The wisdom of these tribunals has never been contradicted except by the self-serving coal establishment. No event of discrimination in the marketplace has ever been claimed, even though Rocky Mountain Energy, for example, has been actively marketing coal from federal leases for ten years. The only claim is that of limp theories in support of potential discrimination. Curiously, those theories are the same ones that for years have been rejected by regulatory authorities and Congress when raised in the context of the competitive risks of industrial integration, like the vertical integration of business segments of the oil industry. Several integrated oil companies own the very coal companies complaining about this "integration" risk with respect to rail affiliated coal companies. The coal industry claims cannot be taken seriously.

I wish to thank you and Senator McClure and others on the Committee who are endeavoring to bring some clarity to the 2(c) issue and to the other needed modifications of The Mineral Lands Leasing Act of 1920.

Sincerely,

James C Wilson

Attachments

cc: Honorable James A. McClure

RESPONSES OF JAMES C. WILSON, PRESIDENT AND CHIEF EXECUTIVE OFFICER OF ROCKY MOUNTAIN ENERGY COMPANY TO QUESTIONS PROPOUNDED BY THE SUBCOMMITTEE ON NATURAL RESOURCES PRODUCTION AND DEVELOPMENT, SUBSEQUENT TO NOVEMBER 8, 1985 HEARINGS ON AMENDMENTS 801 and 802

A. Questions for Railroad Affiliates

1. Question: What is your response to Mr. Holsten's testimony that railroads would use their alleged transportation monopoly to discriminate in favor of their coal affiliates with respect to rates and conditions of service?

Answer: Mr. Holsten's speculation is unsound in theory and unsupported by any facts. It assumes that railroads would act against their business and economic interests, and in the face of severe potential antitrust penalties, in order to obtain a coal contract for an affiliated coal company. This implausible time-worn claim has been considered and rejected by the Antitrust Division of the Justice Department, by a Congressional Research Service study, and by the Linowes Commission. Mr. Holsten's testimony offers nothing at all to show why all these impartial observers are wrong.

Even Mr. Holsten does not allege that any railroad has ever engaged in any discrimination against competitors of an affiliated coal company. My company and other coal affiliates of railroads have been mining and selling their own coal for a number of years. To my knowledge, there has never been even a single claim that an affiliated railroad has discriminated in favor of such coal. On the contrary, a coal industry spokesman acknowledged to the Linowes Commission that he could make no such claim. And in testimony before this Committee on section 2(c) in 1983, I believe it was Carl Bagge himself who testified in response to a question from Senator Warner--that he was not personally aware of any instance where the rails have refused to build spurlines or provide other services to competing coal companies.

That there has been no such discrimination is hardly surprising. There is no economic incentive for a railroad to shave its rates or give better service to an affiliate, when by doing so it would reduce its own profits. As a coal company CEO, I would not sacrifice my revenues just so that Union Pacific Railroad could increase its rates. And I can tell you from long experience that Union Pacific Railroad would not act to help my Company at the expense of its own bottom line. In some 15 years as President of Rocky Mountain Energy, I have never once obtained any special treatment from the Railroad, whether for my coal or for any of our other minerals that are shipped by the Railroad.

Perhaps Mr. Holsten should be asked a similar question: Would Mr. Holsten's counterpart at Chevron reduce the selling price of natural gas and home heating oil or increase his transportation costs so as to enable Mr. Holsten's Pittsburg and Midway Coal Company to increase its share of an interfuel competitive home heating market? I think Mr. Holsten knows very well that it would not.

As a matter of economics, a railroad and a coal company will both be better off, whether or not they are commonly owned, if each of them acts to optimize its own profits in its own line of business. At the Union Pacific Corporation, that is not only theory but long-established policy and practice. I am expected to look after my own Company and my own bottom line, not to help the Railroad at my expense. The same self-interest is expected of the Railroad.

In any case, as the Justice Department's 1980 study of competition in the coal industry demonstrated, most western railroads do not have the kind of market power that could affect long-term coal purchases. In the few instances where such market power may exist, the Justice Department has said that it has ample power to police it. And as I make clear below in response to Question 4, if a railroad has a monopoly transportation position that would make discrimination possible, it would be ill-advised to abuse its position to favor a coal affiliate in the face of the formidable array of antitrust penalties that such discrimination would invite.

2. Question: What is your response to Mr. Holsten's testimony (page 8) that "even assuming comparable rates are quoted by the railroad, what assurance is there that there would not be an unfair allocation between the quoted freight rate and the affiliate's mine price so that most of the railroad's total profit for the two functions, mining and transportation, would be allocated to the freight rate."

Answer: This latest hypothetical concern--which was never mentioned in the six months during which the coal companies were supposedly discussing with us their concerns about repeal of Section 2(c)--is particularly far-fetched. It assumes that, rather than giving a coal affiliate a discriminatory rate break, a railroad will raise its freight rates to the affiliate and all other companies competing for a particular coal contract as part of a scheme to enable the affiliate to win the contract by selling its coal at an unprofitably low price. This theory makes no sense for several different reasons.

First, as a preliminary matter, for such an elaborate strategy to be successful, there would have to be a major change in the way that coal purchase contracts are made. I think Mr. Holsten and I both know that coal purchasers ordinarily treat the coal supply contract and the freight transportation contract as separate and independent transactions. In fact, freight rate negotiations are rarely concluded prior to the finalization of the supply contract. That is the way all my coal supply contracts have been handled. The coal company as a non-participant seldom has any knowledge of the purchaser's freight rate negotiations and never is in a position to influence the outcome of freight rate negotiations with the railroad. The independent nature of coal and freight contracts preclude Mr. Holsten's hypothetical strategy from ever being effected.

Second, the railroads are not free, as Mr. Holsten's hypothetical strategy assumes, to raise their rate for particular shipments whenever they wish to influence a contract award. It is my understanding that if a shipment is covered by an existing tariff, the railroad is required to adhere to the tariff. It cannot charge a higher rate. The Staggers Act does permit railroads to negotiate individual contract rates for particular shipments, but this allows a railroad to lower its rates below the tariff, not to raise them.

Obviously, a purchaser would not agree to a negotiated contract rate that is higher than the rate to which it is entitled under the the published tariff. Even if there is no published tariff (and thus no existing rate to be raised) the railroads are not free to set whatever rate they wish in order to help a coal affiliate. A new tariff filed by a railroad with market dominance as to the affected coal shipments is still subject to ICC regulation, and a railroad could not defend the reasonableness of a proposed high rate by relying on its interest in subsudizing an affiliate's coal bid.

Third, and most fundamentally, if a railroad could profitably raise its rates as Mr. Holsten suggests, it would do so without regard to whether its coal affiliate had an interest in the transaction and without regard to repeal or modification of Section 2(c). If a railroad could raise its rate by five dollars a ton and thereby increase its profits by the same amount, why would it not already have done so? This is the first time I know of that a coal company has suggested that the railroads are charging less than they could profitably charge for coal transportation. If the railroads are already charging what the market will bear, as the coal industry elsewhere contends, they would only lose business by trying to raise rates any further for the benefit of an affiliate.

Mr. Holsten appears ignorant of the competition between coal basins in the real world of today's coal business. Coal purchasers are keenly aware that southern Wyoming coal (which my company mines and which is shipped by the Union Pacific Railroad) can be played off against Colorado coal shipped on the Denver and Rio Grande or coal from the Raton Basin shipped on the Santa Fe Southern Pacific as well as other coals. Holsten's scenario suggests that coal purchasers do not shop around; nothing could be farther from the truth. Attempts at anticompetitive behavior would be recognized instantly by coal purchasers and would steer business to other basins.

Finally, as I pointed out in response to Question 1, even if Mr. Holsten's hypothetical strategy were legally and commercially possible, it would not occur at Union Pacific or at other companies where the railroad operations and coal-mining operations are separate and independent profit centers. I am accountable to the Board of Directors of the Union Pacific parent company for my profits and losses separately from those of Union Pacific Railroad and its management. For the Board's purpose, we each have appropriate standards of performance against which our respective results are compared. Performance departures call for explanations and I can assure you that an explanation sounding like "stacking the deck" would simply be unacceptable to the Board.

3. Question: With respect to your discussion with your industry opponents to modification of 2(c), Mr. Holsten testified (page 9) that "the industry groups that met this summer did discuss our transportation concerns but the remedies offered to avoid the potential of discriminatory rate making are all after the fact, after the business had been awarded, and hence of little value to a commercial producer who had already lost the business to a railroad's mining affiliate." Please comment on that analysis.

Answer: The proposals the rail affiliated coal companies made in a good faith attempt to resolve our differences with the coal industry were made in response to the concerns that were expressed to us. We originally proposed a remedy for the alleged danger of discrimination in favor of an affiliated coal company patterned after the remedy already contained in the Interstate Commerce Act for discrimination against shippers of agricultural commodities. We were then told of a new, major difficulty with this remedy which was that coal companies would not be able to obtain enough information about coal supply contracts in time to do anything about possible discrimination. Accordingly, we proposed early disclosure requirements for both the transportation contract and all transportation bids made by the railroad as well as for the coal supply contract. This is essentially the proposal contained in Senator McClure's Amendment 801.

I do not know what to make of the complaint that this remedy is "after the fact." Surely Mr. Holsten is not proposing that a supply contract be disclosed to competitors prior to the award of the business. To do that would not only be contrary to prudent business practice but would promote price fixing and other anticompetitive practices. The disclosure provisions of Amendment 801 will enable any coal company that believes it has been the victim of discrimination to discover the facts it needs to know in order to challenge the discrimination, whether under the antitrust laws or under an Interstate Commerce Act remedy or otherwise. If lack of information was the problem, we believe our proposal has addressed it.

Part of the problem in attempting to resolve bona fide concerns of the coal companies has been our inability to get any coherent response from their side. By mid-June, when our legislative proposals had been drafted, we still had no response at all to the original conceptual proposal for a legislative solution that we made in March. We never did receive a counter-proposal of any kind.

4. Question: Please comment on Mr. Holsten's testimony (page 12) that "under the Interstate Commerce Act rate discrimination against a coal shipper is not illegal when the traffic is covered by a transportation contract."

Answer: Railroad transportation contracts that have been approved by the Interstate Commerce Commission are not subject to the rate discrimination provision of the Interstate Commerce Act. But it does not follow that anticompetitive discrimination by means of such contracts would be lawful. I am not a lawyer, but I am advised that a railroad's unreasonable discrimination against competitor's would be subject to the full range of antitrust prohibition under the Sherman Act, including in particular those directed against monopolization.

If a railroad has a coal transportation monopoly, and is therefore in a position to discriminate against a competitor of an affiliated coal company without simply losing the coal competitor's rail business to a rival transporter, any improper anticompetitive use of the railroad's monopoly power would expose it to the risk of liability for monopolization under the Sherman Act. The costs of such antitrust violations--treble damages, possible criminal prosecution, and costly litigation--are extremely severe.

The railroads could be confident that any coal company injured by a discriminatory rail contract favoring a railroad's coal affiliate would soon be in court with a major antitrust suit claiming three times the amount of actual damages plus attorneys' fees. The coal companies would have no trouble learning of such discrimination from their utility customers, and in any event section 4 of Senator McClure's amendment would enable them to obtain the relevant facts from the Secretary of the Interior.

Besides exposure to antitrust liability, a railroad that uses monopoly power to discriminate in favor of its coal affiliate would jeopardize the affiliate's prospects for obtaining federal coal leases. Under section 15 of the 1976 Federal Coal Leasing Amendments Act, all proposed federal coal leases must be submitted to the Attorney General for an antitrust review before they are issued, and a lease ordinarily cannot be issued if the Attorney General advises that it would create or maintain a situation inconsistent with the antitrust laws. If the Attorney General concluded that leases to a railroad affiliate were leading to anticompetitive abuses, the affiliate could be effectively barred from federal leasing.

5. Question: What is your response to Mr. Holsten's suggestion (page 14) that, if section 2(c) is repealed, the present exemption of railroads from the prohibitions of unfair trade practices under the Federal Trade Commission Act would have to be re-examined?

Answer: The railroads' exemption from the Federal Trade Commission Act has nothing to do with section 2(c). Section 2(c) was not enacted until 1920, six years after the Federal Trade Commission Act was passed. That act exempted railroads from regulation by the Federal Trade Commission because railroad regulation was the responsibility of the Interstate Commerce Commission. Since there was no section 2(c) when the Federal Trade Commission Act was adopted in 1914, it is obvious that railroads were not exempted because of or in reliance on section 2(c).

Moreover, as Mr. Holsten should be aware, the FTC's enforcement of the prohibition against unfair trade practices has long been directed primarily at deceptive advertising and other practices outside the area of antitrust enforcement. The heart of the protection for competition under the antitrust laws is the Sherman Act and the Clayton Act. The railroads are not exempted from the liability by those Acts, which are enforced by the prosecutorial powers of the Justice Department's Antitrust Division and by private suits. As I observed in response to Question 4, a railroad would be at serious risk under the antitrust laws if it were to abuse any monopoly power it might have by any improper discrimination in favor of its coal affiliate against a competing coal company.

6. Question: What is the significance of the fact, pointed out by Mr. Holsten in his testimony (page 16), that only 2 of 5 members of the Linowes Commission recommended repeal of 2(c)?

Answer: I attach no significance to Mr. Holsten's point. Although I was not present when the Commission voted, it is my understanding that three members of the Linowes Commission appropriately recused themselves on both section 2(c) and section 3 because of real or perceived conflicts of interest. Therefore, the vote was not two out of five votes, but more truthfully and accurately two out of two. Those actions preserved the integrity of the Linowes Commission Report which I believe to be the most extensive review and recommendation in support of modifying section 2(c).

Moreover, while only the two voting commissioners specifically recommended repeal of 2(c), the entire Commission concluded that restrictions on railroad acquisition of federal leases has impeded development of the federal coal in railroad checkerboard areas, and that steps should be taken to facilitate development of that coal. The Commission's Report also contains a specific refutation of the principal arguments made to the Commission by the coal industry in opposing repeal.

In addition, it should not be forgotten that the recommendation for repeal of section 2(c) echoed the conclusions of a succession of other independent tribunals over the years, including the Public Land Law Review Commission and the Justice Department's Antitrust Division under both the Carter and Reagan Administrations. Although Mr. Holsten would like to imply otherwise, the Linowes Commission arrived at the same conclusion. I find that significant.

7. Question: What is your response to Mr. Holsten's suggested "resolution of the section 2(c) problem" on page 17 of his testimony and his recommendation that any action on 2(c) "should proceed separately from consideration of needed amendments to sections 3 and 7" (page 18)?

Answer: Mr. Holsten's proposal (which, I might note, was not made at any time during the six months of discussions in which the railroad affiliates attempted to reach an accommodation with him and his coal industry colleagues) would repeal section 2(c) only for leasing outside a railroad's "exclusive service area." It would leave a railroad coal affiliate barred from leasing anywhere in the railroad's land grant and anywhere in an undefined broader area where the railroad is deemed to provide the exclusive rail service for the coal shipment.

Holsten's proposal would deprive both the railroad coal affiliates and the public of most of the benefits of allowing railroads and their affiliates to compete for federal leases. It would prevent us from becoming competitors in the major active areas of the federal coal leasing program, and would continue to frustrate the development of our coal reserves. This would not only be unfair to the rail coal affiliates, it would, as well, continue to retard the development of federal coal in the land grant checkerboards by excluding those companies that have the strongest interest in development. The railroad coal affiliates have a stronger interest than others in developing this federal coal because, as long as it is not developed, the contiguous railroad coal reserves go to waste. The rail coal affiliates are, therefore, more likely to commit resources to land-grant coal development than other coal companies and more likely to bid aggressively for federal leases in the land grants. It is because of this prospect of real competition from coal affiliates that the coal industry wants continued protection from 2(c).

Mr. Holsten's proposal does have the merit of effectively acknowledging that there is no possible reason for excluding the railroad coal affiliates from leasing outside the railroad's respective service areas. Now, finally, everyone agrees that this exclusion is indefensible. But the concession on this unarguable point ought not to obscure the lack of justification for disqualifying railroad-related mining companies from competing for federal coal leases where they are most likely to provide effective new competition.

With regard to timing, I strongly disagree with Mr. Holsten's suggestion that section 2(c) should be considered separately from consideration of amending sections 3 and 7. Section 2(c) is not a "complicated" question. It has been complicated only by the inventiveness of the coal industry organizations in contriving new theoretical objections to amending 2(c) as fast as their old objections are shown to be untenable.

Section 2(c) and section 3 are linked in important ways. They are both coal leasing provisions, not transportation provisions. The case for modifying both of them rests importantly on the Linowes Commission's recommendations for needed improvements in the federal coal leasing program. The issue as to both is whether certain companies are to be arbitrarily excluded from competing for federal coal leases.

The coal industry has its own agenda of complaints about deregulation of railroad rates, which are not in any way peculiar to coal transportation and which are outside the jurisdiction of this Committee. Complaints about insufficient ICC regulation of railroad coal rates ought not to be addressed in the context of reform of the federal coal leasing program. The proposals for 2(c) modification we made to the coal companies attempted to address the railroad issues that are peculiar to 2(c) modification. For resolution of other railroad issues, this is the wrong committee and the wrong legislation.

Section 2(c) and section 3 are also linked in another important way. For decades, the only coal companies interested in significant development of western coal were the railroads. The rest of the coal industry was more interested in protecting its eastern coal. With railroads disqualified from federal leasing, other coal companies acquired large volumes of federal leases cheaply and did not develop them. The accumulation of undeveloped leases, in the face of growing national demand, led to the enactment of section 3 of the 1976 Coal Leasing Amendments Act. We agree with the rest of the coal industry that this legislative remedy was too sweeping and should now be modified. But it would be a mistake to remove the sanctions of section 3 without at the same time providing the spur of competition that would come from allowing the railroad coal affiliates, which have the greatest interest in development, to compete for federal leases in the area.

In addition, I would like the Subcommittee to know that the same interests who cry for immediate action on sections 3 and 7 also let well over 90 days in 1985 pass without even the courtesy of a response acknowledging receipt of our initial conceptual proposal to modify 2(c).

I would suggest that those 90 days of silence from the industry could have been spent working out a compromise on 2(c) or at least offering improvements to either our conceptual or later legislative proposals. Mr. Holsten's assertion that 2(c) should not proceed as a package with the legislation he regards as urgent really begs the issue.

The industry failed to suggest to us any substantive improvements or alternatives to our proposal at any time throughout 1985. The discussions terminated with nothing more than criticisms from the coal companies, followed by an attempt to change the subject to "other railroad issues" after avoiding serious negotiations all year. To now assert an eleventh hour claim that time has suddenly become of the essence severely stretches the notion that the coal industry has been a participant at the 2(c) table in good faith.

8. Question: Please comment on Mr. Holsten's testimony that Lee Ranch was "put into operation knowing 2(c) is in effect."

Answer: Since Lee Ranch is an SF Minerals property, I have no reason to respond to this question. I understand Mr. Zitting will respond for SF Minerals.

9. Question: Mr. Holsten suggests in his testimony that SF Minerals has not been leasing coal, but waiting for the repeal of 2(c). How much coal does SF Minerals control? Of this, how much is under lease or committed to a purchaser?

Answer: I understand Mr. Zitting will respond on behalf of SF Minerals.

10. Question: During the question period after your testimony, Senator Ford read an excerpt from testimony before the Linowes Commission by Donald Young, Director of the ICC's Bureau of Accounts. In that excerpt Mr. Young stated: "Except in the case of agricultural commodities or challenges by courts, the Commission may not disapprove a contract because a rate unreasonably discriminates against some other shipper. Therefore, it is possible that a rail carrier could negotiate a contract rate with its mining subsidiary which was significantly lower than the rates charged to other coal shippers." Given Senator Ford's concern and Mr. Young's statement, would you be willing to consider a statutory requirement that a procedure and remedy identical

to the agricultural commodities procedure and remedy shall be available to competing coal producers whenever you hold a federal coal lease within your railroad affiliate's exclusive service area?

Answer: I would have no objection to such a statutory requirement, so long as its consideration would not create a jurisdictional dispute and delay with the Commerce Committee. In fact, the rail affiliates proposed such a remedy to the coal industry last March (1985). I do believe, however, that such a procedure is unnecessary to prevent improper discrimination against competing coal companies. No railroad that I know of--and certainly not Union Pacific Railroad--is willing to sacrifice its own revenues or its relations with other coal customers in order to help its coal affiliate get a contract. My company has been producing and selling coal that is transported on Union Pacific Railroad for many years, and to the best of my knowledge there has never been a complaint of discrimination lodged against Rocky Mountain Energy or the Railroad. It would be against the Railroad's business interest to discriminate against our competitors, and as I have already pointed out above, an anticompetitive use of a railroad's monopoly power could risk serious antitrust liability by engaging in such conduct.

I would also respond that coal companies do not negotiate transportation with the railroads, the shippers do. The coal shippers are the utilities, not the coal companies. Interestingly enough, the effect of a lower rail rate is that the consumer gets a better deal.

11. Question: In Mr. Holsten's testimony he said he had requested an opportunity to discuss "transportation and ....antitrust" issues concerning 2(c) with your holding company or railroad affiliate. He added that "to date, any request for such a meeting has been denied us." Please confirm whether such a request was made to your holding company or railroad affiliate and describe both the nature of the request and any response made by the parent or affiliate.

Answer: The coal companies represented by Mr. Holsten have been denied nothing. At every step in the consideration of their expressed concerns, a good faith effort has been made by the rail affiliated coal companies to find a workable answer. This is true of claims of

- drilling data advantage
- unfair bidding advantage
- potential regional dominance
- potential discriminatory pricing of affiliate coal and rail services.

When full disclosure of all contracts was proposed by us as an answer to the latter claim, the coal companies attempted to sidestep the real issue once again.

They suggested that the real (and perhaps ultimate) solution lay in resolving their frustrations over rail service regulation generally; and that they wished to talk to someone in our corporation on those matters. At this point, I responded to Mr. Holsten at several levels:

- I reminded him that the Senate committee's concerns (and jurisdiction) were confined to coal leasing act amendments, of which 2(c) was a principal one. If rail regulation was to be raised, it had to be raised in an entirely different setting where users of rail services generally (not just coal producers) would have their day in court.
- I told him that while the chairman of Union Pacific Corporation, the holding company, would be pleased to meet Mr. Holsten, if Mr. Holsten wanted to talk rail regulatory issues, he would have to talk to the chairman of the rail subsidiary, just as he was talking to me, head of the mining subsidiary on coal leasing issues. And, I reminded Mr. Holsten that the National Coal Association (NCA) was even then discussing Staggers Act questions with the staff of the Association of American Railroads (AAR). There was simply no impediment to the coal industry engaging in discussions about Staggers.
- I further related to Mr. Holsten that if he and his associates thought there was some potential for trading Staggers "remedies" for 2(c) "remedies," he was mistaken. The two businesses as well as their respective legislative agendas were simply separate matters.

And so what the Subcommittee then heard about in reality was Mr. Holsten's inability to transform Staggers into a roadblock for 2(c) modification.

Mr. Holsten told me that a third of his constituents had no problem with 2(c) repeal; another third had problems but were willing to negotiate a workout based upon our proposal; and the final third held such strong feelings of animosity toward railroads, generally, that they would never agree to any modifications of 2(c). I am convinced that Mr. Holsten was speaking primarily for the coal companies making up this third group.

B. Questions Submitted by Senator Bumpers

1. Question: Why should railroads or their mining affiliates be given the right to lease federal coal when they have opposed development of alternative forms of transportation, such as coal slurry pipelines?

Answer: Our support for modifying section 2(c) is not inconsistent with Union Pacific Corporation's opposition to granting federal eminent domain powers to coal slurry pipelines. In the case of each proposal, the question is whether the effects on competition of the proposed legislation would serve the public interest and be fair to all interested parties. The proposals are quite different, and so is their effect on competition.

In the case of section 2(c), the question is whether railroads should be subjected to a unique statutory disability--namely, exclusion from competing for federal coal leases. In the case of proposals to give coal slurry pipelines eminent domain powers, the question is whether the pipelines should be granted a unique statutory advantage over their competitors. In addition, while the impact of section 2(c) modification is narrow, the coal slurry pipeline legislation raises broad issues of environmental impact and depletion of scarce water supplies in the West. There can be no doubt that the issues coal slurry pipeline legislation present are different from the merits of 2(c) modification.

2. Question: I understand that independent coal companies and the railroad mining affiliates have been working together towards a compromise on section 2(c) leasing provisions. It is also my understanding that requests made by the coal companies to meet with management of the railroad holding companies for discussions of transportation issues have been denied. Is this correct? If so, why were these requests denied?

Answer: Your understanding that railroad mining affiliates have been working toward a compromise on section 2(c) is correct. I seriously question whether the other side has wanted to achieve any compromise.

Mr. Holsten's request to meet with the Chairman of Union Pacific Corporation, which is the parent holding company of my company, was made in a way that seemed transparently designed to further delay progress in reaching a compromise rather than to assist it. I had authority to negotiate with Mr. Holsten on 2(c) issues, including any railroad-related questions peculiar to 2(c). We put proposals on the table which attempted to address the coal industry's concerns about rail transportation contracts with coal affiliates, as well as their concerns about other leasing questions. After six months of not responding to these proposals, Mr. Holsten rejected the proposals outright, without making any counter-proposal and requested a meeting with the Union Pacific Chairman to discuss unspecified other railroad issues.

Since the coal industry had put nothing on the table at all regarding 2(c), I had no basis for recommending a meeting with the Chairman. Nonetheless, I did not, as Mr. Holsten testified, deny his request. Instead, I wrote him (letter attached) six days after receiving his September letter requesting such a meeting to invite Mr. Holsten to identify what he proposed to discuss at such a meeting, explaining that I was at a disadvantage to recommend a meeting with the Chairman without something more by way of an agenda than a vague reference to "....other issues involving railroad matters...." I concluded that "if [Mr. Holsten] would care to frame an agenda or proposals, I could then appropriately advise New York." Mr. Holsten ignored this invitation, did not offer any agenda or proposals, and instead came to the Subcommittee hearing in November claiming that negotiations had been stalled because he was denied a meeting of principals.

The rail coal affiliates have been trying to discuss section 2(c) issues, including related railroad issues, with the coal companies ever since February 1985. We got nothing from them except a belated request to meet with holding company management on "....other issues involving railroad issues...." We went the extra mile to attempt to accommodate legitimate concerns, and got no response except a request to talk to someone else about unspecified other issues.

3. Question: Please provide a statement on the positions of the Union Pacific, Burlington Northern and Atchison, Topeka and Santa Fe Railroads on coal slurry pipelines. Specifically, would they favor the grant of Federal eminent domain rights across rights-of-way to slurry pipelines?

Answer: Although I do not speak for the Union Pacific Railroad, it is my understanding that it has been opposed to granting the right of Federal eminent domain to coal slurry pipeline operators for a number of reasons. It does not believe an extraordinary power of condemnation should be given at the federal level to entities that would not be common carriers. With this special federal authority, coal pipelines would also have a serious impact on the nation's rail system. Coal slurry pipelines could easily "skim the cream" -- taking the railroads' high volume coal traffic and leaving rail carriers with the common carrier responsibility to serve other shippers, including small coal shippers and receivers. In addition, there are serious concerns about the future availability of water for agriculture in the West. Union Pacific Railroad is a major carrier of agricultural commodities.

In late 1980 the Staggers Act gave railroads the ability to enter into long-term contract rates -- although unlike slurry systems, the railroad also has common carrier responsibilities. As I understand the situation, at least in the West, with railroads having contract authority coal slurry cannot compete on the economics. Nevertheless, the coal slurry pipeline would receive an unfair advantage if it were permitted to exercise the special privilege of Federal eminent domain without the obligations of a regulated common carrier.

C. Additional Questions Submitted by Senator Johnston

13. Question: Do you think the current market conditions support additional coal leasing at this time? Why or why not?

Answer: Although today's coal market is soft, the question is not whether it will support additional federal leasing, but whether there is sufficient interest among potential lessees to pay the bonuses and rental fees necessary to carry the lease(s) for its initial term. Further, the market 8 to 10 years from now is more likely the arena in which new federal leasing in 1986, 1987 and beyond will actually produce.

In economic terms, the market place will determine which coal is mined and when, regardless of whether it is federal or private coal. Rocky Mountain Energy will lease its coal if the lessee is willing to meet our bonus and diligence requirements. With respect to the federal coal, which is a public resource, any level of leasing without both reasonable diligence and economic penalties for non production should be prohibited. With these assurances in place to protect the public interest against speculation, unlimited leasing is justified. After all, putting the federal resource up for lease does not guarantee it will be leased. Only the market and the lessees perception thereof will make that determination.

D. Questions For All Witnesses on Panel I.

1. Question: As you know, Senator McClure has introduced two amendments pertaining to section 2(c) of the Mineral Lands Leasing Act. One amendment would repeal that provision. The other apparently represents an effort to reach a compromise on the issue. Could you support both amendments?

   Answer: Yes, I could support either amendment; however my preference would be the repeal amendment, No. 802. I continue to feel that the fears and assertions regarding the potential for anticompetitive discrimination in rate making and service, as well as price adjustment by and between the railroads and mining affiliates are without merit and have no factual basis.

2. Question: Do you think that complete repeal of section 2(c) would have anticompetitive effects?

   Answer: No, repeal of section 2(c) would expand competition for federal coal leases. Federal lease sales would potentially have more bidders, and the rail affiliates could pursue acquisitions of operations which contain existing federal leases. Multiple use land management objectives could be pursued covering both the land grant and federal coal resources and if leased, the Treasury could receive additional revenues.

3. Question: Do you think we could alleviate concerns about these anticompetitive effects in the area of coal transportation by moving forward with coal slurry legislation? What are your views on coal slurry?

   Answer: I believe repeal of section 2(c) would be procompetitive, not anticompetitive. Coal slurry legislation is not necessary, therefore, to "balance" repeal of section 2(c). Further, coal slurry pipelines intend to serve only the largest volume movements and do not effectively address the concerns of the opposition as do our proposals. More significantly, the important bases for opposition to coal slurry pipelines -- common carrier regulation, water supplies and impact on jobs -- are not alleviated by increasing competition among coal producers through the repeal of section 2(c).

4. Question: Senator McClure's Amendment No. 801 provides that railroads or affiliated companies leasing federal coal must comply with certain conditions (such as cooperative leasing and sharing of exploration data) only if the Secretary of Interior finds that competition for the federal lease would be

"substantially enhanced thereby." What criteria do you think the Secretary should apply in making the determination that competition would be "substantially enhanced?"

Can you think of circumstances under which competition would not be substantially enhanced by the sharing of data or guarantee of cooperative leasing?

Answer: The criteria which the Secretary of Interior should consider in making the determination of enhanced competition should be the subject of formal rule making and full public participation. Without prejudice to later comments that Rocky Mountain Energy might submit, I would think that the Secretary's determination should be based on whether bona fide companies, other than the rail-affiliated company, would bid on the lease if cooperative leasing is to be required, and conversely, the companies would not bid if cooperative leasing will not be required. I would imagine that the Secretary would review previous expressions of interest or activities in leasing federal, state, Indian or private coal in the area, the existence of other mines or developable properties and potential market or actual customers for the leaseable resources. These, and I am sure other information and criteria which would be proposed during the rule making could be used to determine if others would likely bid on the federal coal.

Presumably, then, if one could conclude that others would participate in the bidding for the cooperative lease package, then "enhancement" is likely. The Secretary would then require the affiliated coal company to put up its resource for bid with the Federal resource in order to participate in the bidding process.

In the event that the Secretary's evaluation process reasonably concluded that no other bonafide bidder(s) would bid on the cooperative lease package containing the federal and rail affiliated coal, then cooperative leasing would not substantially enhance competition. The affiliate could then participate in the bidding for that particular tract without putting its own resource up for cooperative bid. I would also hold that legitimate by-pass and maintenance tracts would not be subject to cooperative leasing.

5. Question: Amendment No. 801 employs the term "potential mining unit." What criteria do you think the Secretary of Interior should apply in designating "potential mining units"?

Answer: Whatever definition the Secretary employs should be developed through rule making and full public participation. Again, without prejudice to comments Rocky Mountain Energy might make in future rule making, by definition a "potential mining unit" is likely to be an area which includes all the coal that could reasonably be produced from a unified mining operation (consisting of one or more properties, generally, but not necessarily contiguous). An absolute contiguity requirement makes the exception impossible.

Further, all of the coal resource in the "potential mining unit" should have the capability of being moved, processed, and loaded through a single loadout facility. Obviously, engineering, geologic and economic data would be important considerations. Because this data varies in accordance with mining conditions, arbitrary size limitations would not seem prudent. From a practical standpoint, market conditions and the needs of coal purchasers will be major elements in defining a potential mining unit.

ROCKY MOUNTAIN ENERGY

A Subsidiary of
Union Pacific Corporation

James C. Wilson
President

September 27, 1985

Mr. R. M. Holsten
President
The Pittsburg and Midway
Coal Mining Company
1720 Writers Four
1720 South Bellaire
Denver, CO 80222

Dear Mr. Holsten:

I was disappointed to receive your letter telling me your group of coal companies had rejected our legislative proposal dealing with 2(c) transportation and coal leasing issues. It is difficult to accept that you have neither offered alternatives acceptable to you nor articulated more clearly the "...other issues involving railroad matters..." which you have raised.

The reports I have had of the two meetings held were positive and indicated a better understanding of the issues by both sides. The first two meetings were characterized as "introductory" and "technical"; we had expected an early scheduling of a third meeting in which substantive negotiations would take place.

We were also surprised at the apparent lack of understanding of some aspects of the proposal. The most glaring example is the additional acreage limitation. The 23,000-acre limit is real -- it would only allow RME an additional 9,000 acres within the Land Grant. The ability to acquire leases adjacent to fee holdings outside the Land Grant is exactly the same as available to you. Other issues were similarly misunderstood. If a third meeting is needed to clarify the proposal, we would oblige.

Absent any agenda but "...other issues involving railroad matters...," I am at a disadvantage to recommend a meeting of principals. If you would care to frame an agenda or proposals, I could then appropriately advise New York.

I know I also speak for Meridian and Santa Fe Minerals when I say we continue to believe our proposal represents a reasonable solution to your 2(c) concerns. We regret that you chose to reject it without offering alternatives of your own.

Sincerely,

SIERRA
CLUB

330 Pennsylvania Avenue, S.E.
Washington, D.C. 20003 (202) 547-1141

January 27, 1986

Honorable John Warner
Chairman, Subcommittee on Natural Resources
Development and Production
Energy and Natural Resources Committee
U.S. Senate
Washington D.C., 20515

Dear Senator,

Enclosed please find the answers to follow-up questions posed to Panel II after your November hearing on coal leasing. Thank you for the opportunity to respond to your queries.

Sincerely,

Brooks B. Yeager
Washington Representative

Attachment

Answers to 'Questions for Panel II', submitted by Senator Johnston:

(1) All four major western coal regions, the San Juan, Uintah-SW, Green River-Ham's Fork, and Powder River, currently have potential for new federal coal leasing. Sales in each of these regions were suspended by the Congressional moratorium in 1983. Each of these regions contains potential sale tracts of environmental concern. Of greatest concern to the Sierra Club at the present time are the possibility of new sales and excessive development in the Bisti region of New Mexico, in Southern Utah, and in the Yampa River Valley of Colorado.

(2) No. We have never opposed the leasing of by-pass and emergency coal to meet individual mine needs and to prevent the loss of minable federal coal. However, we do not see any need for the leasing of new production tracts in any of the western coal regions at this time. The lack of demand for new production is well documented in the Department's Supplemental EIS.

(3) Areas of particular environmental concern which are currently covered by non-diligent pre-1976 leases include the Kaiparowits Plateau, and area of extreme natural beauty in Southern Utah, the Alton coalfield, contiguous to Bryce Canyon in Southern Utah, and the Yampa River drainage in Colorado.

(4) Yes, we believe additional environmental reviews should be required prior to any extension of a pre-76 lease. Until recently, such reviews were contemplated in the Department's regulations. Under the 1982 Coal Management Program, pre-76 leases were to be screened for unsuitability as part of the Department's long-term land planning process. Both unsuitability screening and the multiple use screens currently required by Department regulations should be applied to pre-76 leases prior to any extension.

(5) Lessees holding pre-76 leases may or may not be 'grandfathered', depending on the specific environmental statute to which reference is

made.

(6) The operation of the current law, particularly Section 2(a)(2)(A), would effectively encourage the relinquishment of many non-diligent leases covering environmentally sensitive lands.

(7) Yes. Fluctuations in the coal market are not logically related to the responsibility of industry to meet the contractual terms of a lease, or to meet the statutory requirements established by the Congress. The risk of market alterations is undertaken at the time of lease purchase, and should be reflected in the price industry is willing to pay for particular tracts. In most cases, the pre-76 leases were obtained virtually free of charge.

(8) Yes.

(9) It is not unreasonable to substitute a scheme of advance royalties for the current fixed diligence deadline. However, such advance royalties should not be refundable against production, and should be set at a level which discourages speculative lease holding or acquisition. The payment levels currently suggested in S.372 and S.570 are, in our view, far to low to meet this goal.

(10) The Sierra Club disagrees with the Department's willingness to allow leaseholders to tie up the public's resources indefinitely without production.

(11) Please see our written testimony for our position on the 2(c) issue.

(12) We do not endorse the total repeal of the LMU contiguity requirement. The LMU is already used in many cases as a method of circumventing production and other requirements which would apply to any individual tract. Such 'unitization' may be in thepublic interest if it contributes to an efficient mining operation, but it is unlikely to serve the public interest where it exists as a merely formal mechanism

for avoiding the application of lease terms to individual tracts.

(13) The 40-year mine-out requirement reflects a rational view of mine life based on historical experience. It is part of an integrated view of mining operations which lies at the base of many of the Department's other regulatory requirements, including the original diligence requirement of 2 1/2% production per year. We oppose its removal.

(14) We do not disagree with the definition of 'competitive bidding' as the receipt of two or more bids from qualified bidders. However, S.372 also includes, with this definition, language exempting maintenance and by-pass leases from the statutory requirement that all leasing be by competitive bid. Since most major leasing is in the form of maintenance, rather than new production, tracts, this exemption drastically weakens the legal protections which are intended to assure the receipt of fair market value for the public's coal.

(15) One alternative to the negotiated sale of maintenance tracts would be the use of intertract bidding. Please see our written testimony for other comments on this issue.

(16) We have no particular expertise in coal appraisal techniques.

(17) An agreement which reflects our views on the minimum steps necessary to ensure the proper environmental review of PRLAs is now under negotiation with the Department of Justice. We will be glad to provide it to the Committee as soon as it is made final.

United States Senate
COMMITTEE ON
ENERGY AND NATURAL RESOURCES
WASHINGTON, DC 20510

November 19, 1985

Mr. Brooks Yeager
The Sierra Club
330 Pennsylvania Ave., S.E.
Washington, D.C. 20003

Dear Mr. Yeager:

As Senator McClure mentioned at the end of the recent hearing held on coal leasing before the Natural Resources Development and Production Subcommittee, there would be additional questions submitted in writing to the witnesses appearing before the Committee. He also indicated that responses to such questions should be returned to the Subcommittee as expeditiously as possible. Therefore, I would appreciate your prompt response to the attached questions.

I regret that the tragic flooding in Virginia prevented me from chairing the hearing, but I thank you for your excellent testimony and your willingness to respond to oral questioning by the various Senators during the hearing.

Sincerely,

John Warner

John Warner
Chairman, Subcommittee on Natural
Resources Development and Production

JWW/ps/er

QUESTIONS FOR PANEL II

Submitted by Senator Johnston

FOR THE RECORD

(1) What geographical regions with potential for new or additional federal coal leasing do you find of particular concern from an environmental standpoint?

(2) Do you oppose the leasing of any additional federal coal at this time?

(3) Of the areas currently covered by nonproducing pre-1976 leases, which, in your view, are the most environmentally sensitive?

(4) Some have argued that additional environmental review should be required before any pre-1976 noncomplying lease is extended. Do you think this is necessary? If so, what type of review should occur?

(5) Do lessees holding these old pre-1976 leases have grandfather rights under environmental laws making provisions of those laws inapplicable?

(6) What means do you suggest to encourage the relinquishment of pre-1976 leases issued on environmentally sensitive lands?

(7) Do you think that industry should be held to the August 4, 1986, diligent development deadline given the relatively soft state of the coal market in recent years?

- What do you think is a reasonable deadline for diligent development?

(8) Legislation providing for the payment of advance escalating royalties in lieu of production could require that lessees exercising this option must agree to the immediate revision of their federal coal leases to reflect all statutory and regulatory requirements currently in effect. Would you support this?

(9) S.372 and S.570 both amend Section 7 of the MLA to allow lessees to continue to hold nonproducing leases for up to twenty years upon the payment of an advance escalating royalty in lieu of production for years 11 through 20. Please elaborate on your position on this proposal.

(10) The Department's draft of suggested changes to the Amendment to H.R.1934 imposes no limit on the number of years which a lessee could make minimum royalty payments in lieu of production. Please comment.

(11) Senator McClure has introduced two amendments pertaining to Section 2(c) of the Mineral Lands Leasing Act. One amendment

would repeal that provision. The other apparently represents an effort to reach a compromise position on the issue. Please elaborate on your position on each of these amendments.

- What environmental effects would you anticipate as a result of passage of each amendment?

(12) S.570 would totally repeal the requirement that logical mining units (LMUs) be contiguous. A proposal before the House of Representatives (H.R.1934) would allow noncontiguous areas to be incorporated into an LMU only if they are within reasonable proximity of each other and under the effective control of a single operator and incorporated into a single operation.

- Do you endorse either complete repeal or the House approach? Please elaborate on your views.

- What steps should the Department of the Interior take to ensure that LMUs are not used as a vehicle to circumvent the diligent development and continued operation requirements of the MLA?

(13) S.570 and the Departmental draft would eliminate the forty-year mine-out requirement. Do you think this is a good idea?

(14) Senator Johnston's bill, S.372, contains a provision defining "competitive bidding" as the receipt of bids by at least two bidders. Please comment on this method of ensuring that fair market value is obtained for federal coal.

(15) What would you suggest as alternatives to negotiated sale of maintenance and bypass tracts?

- Assuming that experimentation with such negotiated sales is authorized, what limitations on these negotiated sales do you think should be imposed?

(16) What steps should be taken to ensure that federal coal deposits are properly appraised prior to leasing to ensure that fair market value is received?

(17) What steps do you think the Department of the Interior must take, pursuant to Natural Resources Defense Council v. Berklund, 609 F.2d 553 (D.C. Cir. 1980), to ensure that environmental analysis is introduced at "crucial points" in the preference right leasing process?

APPENDIX II

Additional Material Submitted for the Record

STATEMENT OF

MOBIL OIL CORPORATION

TO THE

SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES

SUBCOMMITTEE ON NATURAL RESOURCES DEVELOPMENT AND PRODUCTION

ON

SECTION 3 LEGISLATION

U.S. SENATE

WASHINGTON, D.C.

NOVEMBER 8, 1985

Mobil Oil Corporation (Mobil) appreciates this opportunity to reiterate its support of prompt legislative relief for the problems created by Subparagraph (A) of Section 2(a)(2) of the Mineral Leasing Act of 1920 (MLA), commonly referred to as Section 3 of the Federal Coal Leasing Amendments Act of 1976 (FCLAA). Legislation is essential to eliminate the unreasonable hardship which will result from the current law. Although the Section 3 leasing sanction is not triggered until August of next year, the provision is presently creating considerable uncertainty within the energy industry and promises to be even more troublesome as the deadline approaches. The resulting uncertainty could seriously disrupt the efficient leasing and development of many of the minerals leased under MLA in the years to come. Consequently, there is an urgent need for prompt legislative resolution of the Section 3 problem.

Background

Section 3 of the FCLAA generally has been interpreted as prohibiting the acquisition of future federal leases authorized under the MLA if an entity holds and has held a federal coal lease for ten years and is not "producing coal . . . in commercial quantities." The Act itself fails to define the critical parameters of the production in "commercial quantities" test and only recently has the Department of Interior (DOI) provided any guidance on this question.

Without repeal of Section 3 or other adequate legislative relief, legitimate coal producers found not in compliance with the statute on or after August 4, 1986, will be precluded from being issued leases for any mineral issued under the MLA. The Section 3 provision could jeopardize the goal of energy security--a goal which is vital to this country's economy and security--without serving any national interest.

Mobil and its subsidiaries are significant oil and gas producers which hold a number of federal onshore oil and gas as well as other MLA mineral leases, including coal and phosphate. Since the MLA governs the leasing of all these minerals, the Section 3 prohibition could potentially affect Mobil's ability to secure future onshore oil and gas, coal, phosphate, and other resources, such as oil shale and tar sands, needed for continued energy and minerals production.

Section 3 fails to meet the flexibility required in the extremely competitive coal marketing environment. There is no recognition that legislation requiring coal production does not commensurately create a market for that coal. Levying leasing sanctions for coal and other MLA minerals against legitimate coal developers will decrease future competitive bidding and subsequently federal revenues.

The failure of Section 3 to accommodate the commercial.requirements of coal development and production is exemplified by the lack of legislative alternatives for the "commercial" production obligation. There is apparently no way to avoid Section 3's mineral leasing sanctions by those legitimate coal developers caught in the realities of commercial endeavors, particularly new entrants to the coal business who are attempting to penetrate an established market.

Mobil, through a wholly owned subsidiary, holds one and only one pre-FCLAA federal coal lease (W-23929). In late 1982, after ten years and the expenditure of over $100 million for exploration, permitting and construction activities, coal shipments began from the Caballo Rojo Mine under two long-term contracts. Coal production for 1985 is estimated to be 4-5 million tons, the large majority of which is federal.

Since the legislative intent of Section 3 was to discourage speculative holding of federal coal leases, it would certainly seem that Mobil has complied with the Congressional purpose by our significant investment, construction, and operation of the Caballo Rojo Mine. But until recently, there was no guidance on the fundamental question of what production level would satisfy the Section 3 "producing in commercial quantities" (PCQ) obligation--leaving legitimate developers of federal coal leases, such as Mobil, in doubt as to whether their efforts satisfied the commercial quantities test. DOI has now released final guidelines to answer some of the questions raised by Section 3. The guidelines charge the individual BLM state offices with the responsibility for defining the PCQ obligation on a case-by-case basis. The bottom line is that despite the Department's efforts uncertainties still remain. While Mobil is optimistic that its federal coal lease will be found in compliance with Section 3 on the basis of the DOI guidelines, remedial legislation is still considered desirable to eliminate uncertainties and the linkage between coal lease compliance and oil and gas leasing.

Section 3 has not worked in the way contemplated by Congress. More importantly, the apparent perceptions behind enactment of Section 3 were either unfounded or cured by other measures so that Section 3 is unnecessary. Section 3 is also counterproductive in view of its adverse anti-competitive and disruptive impacts on the development of federal energy and mineral sources. All these reasons support Section 3 legislative relief. Repeal of Section 3 (e.g. S. 570) would obviously provide the requisite relief, but other legislative vehicles are possible. At the minimum, any legislative action on Section 3 should limit the leasing sanctions to coal leases only so that other mineral leasing activities particularly oil and gas are not jeopardized. Mobil also believes that the PCQ test should be defined with sufficient flexibility by Congress so that coal lessees who have clearly complied with the Congressional intent of Section 3 are not penalized.

Discussion

Years are necessary to obtain rights to minable tracts, to permit, and to construct mines. The huge capital investments required to build Powder River Basin mines can not be made until an adequate market is identified and contracts written. Production capabilities must be commensurate with demand--without a market, no coal can be produced.

Section 3 does not make good economic sense. It imposes unknown production requirements on a federal coal lessee over a limited time frame with no regard for market conditions. No alternative means, such as payment of advance royalties, is available to the lessee to satisfy the production requirement. Section 3, at best, may serve the questionable purpose of forcing premature production, thereby dumping coal on a market unable to absorb excess production. This is an unfair and inefficient allocation of capital and resources. The market, not legislation, should determine allocation.

As the Section 3 deadline draws near multi-mineral developers have been reexamining their coal holdings in order to cure non-compliance. The Office of Technology and Assessment (OTA) is currently finalizing a report which will address the overall impacts anticipated from Section 3. While figures are not yet available from this soon-to-be released report, in its 1981 review, OTA estimated that some two-thirds of the pre-FCLAA federal coal lessees face an uncertain future in light of the 1986 Section 3 deadline. Of these lessees, 72 are publicly owned companies and 49 are actively involved in oil and gas development. Elimination of these firms from future MLA mineral lease sales for violation of undefined coal production requirements in Section 3 is an unreasonable and inequitable sanction. Further, it is against the interests of the federal government in obtaining fair market value on future MLA leases. There are often only a handful of bidders on any given lease tract. If just a few key firms are barred from participating, the level of bonus bids could fall significantly and thereby adversely affect government receipts. Likewise, since the affected western states receive 50% of federal bonuses, rentals and royalties on federal coal leases, income to such states will be reduced. It is not in the public interest to retain this ambiguous and ill-defined statutory provision which could so drastically undermine the ability to obtain fair market value for mineral leases.

Underlying the various problems caused by Section 3 is the pervasive concern about the ambiguity associated with the application of Section 3 and the uncertainty generated within the industry by such ambiguities. Many questions have arisen regarding the obligations and liabilities of the federal coal lessee with respect to the production requirement itself, the imposition and removal of sanctions, lease exchange and transfer constraints, and assignments. No one knew if sale or relinquishment would eliminate a Section 3 problem. DOI has provided answers to some of these questions and attempted to provide answers to others but possible vagaries in interpretation and the possibility of future change cast a cloud of doubt that lessees with hundreds of millions of dollars at stake can ill-afford.

In sum, Section 3 has generated much broader and more serious problems than it was designed to solve. Although the full impact of Section 3 will probably not be realized until after the deadline date of August, 1986, it already has created substantial uncertainty and has the potential to significantly impact the effective and efficient development of our national resources.

The Mobil Experience - A Case In Point

Mobil's experience in developing its one and only federal lease illustrates some of the unfair and unreasonable impacts of Section 3 on coal developers. More importantly, Mobil's case demonstrates that despite a sincere and dedicated effort to develop a coal lease, a lessee in full compliance with Department of Interior diligent development requirements may still be placed in jeopardy by the ambiguities and inflexibility of Section 3.

In February, 1971, Mobil obtained its federal coal lease with a high bid of $441 per acre, amounting to a total bonus payment of $1,764,000. At that time, this bid tied for the highest bid for a coal lease. The lease, situated in the Powder River Basin, just south of Gillette, Wyoming, comprises about 4,000 acres and contains approximately 400 million tons of coal.

No statutory, regulatory, or contractual stipulation existed at the time of acquisition that required production to commence by a specific deadline in specific amounts or that production commence or continue without regard to market conditions or other economic considerations. The federal lease form permitted payment of minimum advance royalty in lieu of production. In entering into the lease, Mobil anticipated its rights and obligations as lessee would be governed by the terms of the lease. In 1976, the enactment of FCLAA and the publication of DOI's implementing regulations, which imposed specific diligent development obligations for pre-1976 coal leases, altered these circumstances.

Mobil and its coal-related subsidiaries have been continuously engaged in efforts to develop the federal lease and bordering private lands into a producing property, known as the Caballo Rojo Mine, long before FCLAA was enacted. Drilling was begun within a year of lease acquisition and environmental studies were commenced by 1974. The degree and extent of Mobil's commitment to development is best expressed by some important statistics.

- Over $100 million has been invested in the development of this lease. This includes expenses for development drilling, construction of plant and rail facilities, mining equipment and other capital expenses.

- Approximately 120 employees are engaged at the Caballo Rojo Mine which has an annual operating budget of over $10 million. We expect the employee and operating budget to essentially double as additional contracts are secured and the mine reaches full production.

- Mobil has bid on over twenty-nine long-term coal solicitations that, according to its records, represent all but one of the total offered to Powder River Basin producers during the period 1978 to mid-1985. Half of these solicitations were ultimately withdrawn by the purchasers. Mobil was selected as the coal supplier on three. The three include contracts to supply Wyoming, Kansas and Oklahoma power plants. The successful negotiation of the first two supported the investment decision to build the mine. All of these contracts are long term (20 years or more) and represent over the life of the contracts about 93 million tons of coal--a significant portion of the recoverable reserves contained in Mobil's federal lease.

- Mobil has also been successful in obtaining spot sales commitments and we expect to sell over 2 million tons of coal in this market in 1985.

- Production at the Caballo Rojo Mine commenced in December, 1982. Mobil produced 1.4 million tons in 1983, 3.4 million tons in 1984, and expects to produce 4-5 million tons in 1985. In 1985, federal coal will be the dominant product with fee coal constituting the balance. (Due to economic considerations, production at Caballo Rojo commenced on private lands bordering the federal lease.)

- The mine's permanent facilities and equipment are capable of supporting an annual production of 8 million tons.

In light of this extensive and dedicated effort to develop the federal lease, it seems inconceivable that Mobil could be found in violation of Section 3. Mobil is threatened with such a possibility, however, because of the ambiguous nature of the Section 3 PCQ test. It would seem that Mobil has fully complied with the Congressional intent by the construction and operation of its Caballo Rojo Mine--an operation which required well over $100 million to develop, which is capable of producing 8 million tons of coal per year, and which will be delivering 4-5 million tons per year before August, 1986. Mobil's long and short-term contract customers surely must be considered "commercial."

Without any Congressional action, Section 3 could be applied in such a way that Mobil would fail to meet the "commercial quantities" test despite the magnitude of Mobil's effort. This situation could arise if "commercial quantities" were ultimately defined as an annual production of 1% of a federal lease's recoverable coal reserves--an interpretation which has been urged by some. In this case, Mobil's Caballo Rojo Mine would currently have to be producing at an annual rate of about 4 million tons of federal coal. While Mobil's Caballo Rojo Mine can probably meet this requirement on the basis of current contracts, there is no assurance that this level can be sustained. Presently, the majority of our sales are spot contracts which are subject to the whims of the market place. Long-term contracts also include excuses for performance by either buyer or seller for causes beyond either's control.

Mobil is faced with an unreasonable prospect. It has entered long-term supply commitments and does not intend to do anything that would jeopardize fulfillment of those commitments. It also cannot afford to be in non-compliance with Section 3 because of the unwarranted and severe impact on its on-going oil and gas programs. Mobil's dilemma highlights key problems and difficulties associated with the application and enforcement of Section 3, which we feel are contrary to the original intent of Congress.

Conclusion

Mobil urges Congress to take prompt action. Repeal of Section 3 would obviously provide the needed relief, but at the minimum, Congress should provide legislative relief by limiting the leasing sanction to coal leases. This should be done since the present linkage of coal lease performance with oil and gas leasing activities is discriminatory to oil companies, is anti-competitive and, further, is unprecedented. Mobil also believes that the production requirements test should be defined in such a manner that it recognizes economic realities and is administered with sufficient flexibility so that coal leaseholders who satisfy the legislative intent of Section 3 are not penalized. Associated sanctions for non-compliance should be reasonable, relate directly to the violation, and be applied with minimum adverse impact on overall energy development. Section 3 currently fails to meet these goals.

Any "commercial quantities" definition incorporated in remedial legislation should avoid imposing a fixed production requirement. No set percentage can equate to the concept of a "commercial" operation. The February 12, 1985 Solicitor's Opinion (M-36951) states that when enacting FCLAA, "Congress did not compel the use of a fixed percentage-of-reserves amount as the definition of commercial quantities." DOI should not be using a fixed percentage requirement and Congress should refrain from endorsing the current regulatory practice. Rather, Congress should consider the possible adoption of other definitions, including the concept of "paying quantities." We understand that DOI is already reviewing such possible definitional change as part of its coal regulation overhaul.

A "paying quantities" definition (modified to reflect the realities of the coal industry) would be in accord with the plain meaning of the legislative requirement of "commercial" production. Other definitions are also available which would truly reflect a "commercial" operation. Mobil particularly recommends a "prudent man" definition. In the context of Section 3 compliance, a prudent man definition for "commercial quantities" would be satisfied if a person of ordinary prudence would be justified in the further expenditure of his labor and means with a reasonable prospect of success in developing a valuable mine.

Other suitable definition which could be adopted that are also in line with a "commercial" concept of development include:

- "minimum production which demonstrates good faith in mine development and on-going productivity"
- "production under a bonafide coal sales contract" or
- "production in quantities, which in the judgment of the Secretary, would justify the continued operation of the mine or mines."

Any of these definitions which require actual coal production, coupled with other bonafide development efforts, would create suitable criteria for Section 3 compliance. We strongly urge the adoption of one or more of these definitions.

Additionally, non-compliance could be alleviated through the payment of advance royalties comparable to the "continued operations" requirements already present in the MLA. This method could provide a prompt revenue stream to the state and federal governments. Any sanction devised by Congress, however, should not penalize those lessees that have performed bonafide development work.

In conclusion, Mobil urges prompt action on legislation addressing the urgent issues of Section 3.

[illegible]

STA Slurry Technology Association
1800 Connecticut Avenue, NW • Washington, DC 20009 • (202) 332-5751

George H. Eatman
Executive Director

November 5, 1985

Honorable John Warner
Chairman
Senate Subcommittee on Energy
and Mineral Resources
358 DSOB
Washington, DC 20510

Dear Mr. Chairman:

We respectfully request that the attached document be made a part of the official records of the hearings scheduled on Nov. 8 on Section 2(c) of the Minerals Leasing Act and Sections 3 and 7 of the Federal Coal Leasing Amendments.

Changes proposed in Section 2(c) of the Minerals Leasing Act will allow railroads more freedom and flexibility to mine their western coal holdings. If Section 2(c) is modified or repealed, equity demands that coal slurry pipelines be allowed the right to compete in the market place. This can be achieved by granting federal eminent domain to coal pipelines as provided for in S. 994, the Coal Distribution and Utilization Act. We strongly urge your consideration of coal pipeline eminent domain legislation as a part of any proposed changes made in Section 2(c) of the Minerals Leasing Act.

Please feel free to call me or my staff if you have any questions or comments.

Very truly yours,

George Eatman

GHE/ab
encl.

Dedicated to the advancement of pipeline delivery
of solids and direct firing of coal-liquid mixtures

Testimony of
The Slurry Technology Association

before the

Subcommittee on Natural Resources
Development and Production

of the

Senate Committee on Energy and Natural Resources

on

Amendments to 2(c) of the Minerals Leasing Act of 1920
November 8, 1985

Mr. Chairman and members of the Subcommittee, the Slurry Technology Association (STA) appreciates this opportunity to submit testimony regarding proposed changes in Section 2(c) of the Minerals Leasing Act. STA is concerned that the repeal of Section 2(c) of the Minerals Leasing Act without provisions to provide for increased competition in coal haulage would only exacerbate the lack of competition which already exists in the haulage of coal in this country.

The repeal of Section 2(c) of the Minerals Leasing Act in a vacuum would allow the railroads, particularly those Western railroads which are the beneficiaries of massive Federal land grants, an unfair competitive edge. Those railroads, with billions of tons of coal frequently located close to their rail lines, would now be able to obtain Federal coal leases to combine with their existing holdings in order to form logical mining units.

We believe the coal industry's concerns that the railroads and their mining subsidiaries would have the potential to take unfair advantage of independent coal companies would be ameliorated if coal slurry pipelines were not barred from competing. Equity demands that coal pipelines be afforded the right to compete and that any modifications of Section 2(c) of the Minerals Leasing Act include coal pipeline eminent domain provisions. Additionally, repeal or modification of Section 2(c) and coal pipeline provisions would address the same statute: the Minerals Leasing Act.

NETS STUDY

In 1978, the Departments of Energy and Transportation jointly published the National Energy Transportation Study (NETS) which endorsed railroad deregulation (similar to that enacted in the Staggers Act) and Federal eminent domain for coal slurry pipelines. The enactment of the Staggers Act in 1980 accomplished the railroad deregulation facet of the recommendation. Unfortunately, the railroads' interest in preserving their coal haulage monopoly continued unabated and their large scale lobbying campaign contributed in large part to the defeat of coal pipeline legislation in the House of Representatives in 1983. The NETS report of 1978 recommended deregulation, but it also recommended that potential abuses of deregulation of monopolies could be negated by permitting the marketplace competition provided by coal pipelines. The artificial barriers to competition must be removed if we are to develop and utilize our most plentiful natural resource -- coal.

DOE STUDY

The most recent study by the U. S. Department of Energy, *Effects of Railroad Regulatory Reform on Coal and Electricity* (May 1985) endorsed the need for federal eminent domain for coal pipelines. The DOE study, which dealt primarily with the impact of the Staggers Act on the coal and electric utility industries, stated in relevant part:

> Most of the barriers to the introduction of coal slurry pipeline technology would be resolved if Congress were to extend eminent domain authority to such pipelines. This would permit the acquisition of easements and/or property along an approved route, using long-established principles of fair competition. Without such authority, a coal pipeline can be blocked easily by a railroad serving the same area because it is often almost impossible to choose a pipeline route that does not cross railroad rights-of-way or property that is controlled (directly or indirectly) by a railroad that is unwilling to permit competition in the business of hauling coal.

Of course, proposed pipeleines would still have to meet applicable environmental requirements, water use legislation, requirements for financial viability, and other tests before they became effective potential competitors. The purpose of eminent domain legislation at the Federal level is not to endorse slurry pipeline construction *per se*. It has been proposed by every Administration over nearly a quarter century, however, because it could remove one great barrier that prevents a reasonable consideration of slurry transport as an alternative mode of coal delivery.

Some have argued that it is particularly unfair to allow the railroads to price their services differentially on the basis of demand elasticity when at the same time they can influence that demand elasticity by blocking the construction of coal slurry pipelines. (Footnote: Alfred E. Kahn, "Verified Statement on behalf of National Coal Association before the Interstate Commerce Commission," September 16, 1981.) It is at least questionable whether a regulator can be indifferent to the *reasons* for a given shipper's inelasticity of demand for rail service, where those reasons are the product of artifical restraints on competition. By granting eminent domain rights to slurry pipelines that are deemed to serve the public interest, the Congress could eliminate the most basic barrier rail carriers now raise to the construction of pipelines. In so doing, the pro-competitive effects of coal slurry pipelines could be realized, even if pipelines are not actually built.

EIA STUDY

The Energy Information Administration study, *Coal Slurry Pipelines: Impact on Coal Markets* (April 1985), also endorsed the need for Federal eminent domain for coal pipelines. The study extensively reviewed the record of coal pipelines from an economic, technological and political perspective. This study (a copy of the Executive Summary is attached) concludes in part that:

o "Coal slurry pipelines could be competitive with railroads, if the projected pipeline and rail rates actually prevailed."

o "Coal users could realize savings of between $200 million and $1 billion in 1995, if the four coal slurry pipelines analyzed were built and operated at the estimated rates."

LINOWES COMMISSION STUDY

In February 1984, the Commission on Fair Market Value Policy for Federal Coal Leasing, chaired by David F. Linowes, issued its report after six months of hearings, analysis and drafting. "The Commission concludes that greater competition in the transportation of Federal coal is desirable. Coal slurry pipelines offer the prospect of increasing such competition. Even if slurry pipelines are not built, the possibility of their construction creates competitive pressures for lower railroad rates for coal. Utilities and ultimately electric power consumers should benefit from any reductions in coal transportation rates." Among the many recommendations made regarding Federal coal leasing, the Commission recommended that, "To promote greater competition in transporting Federal coal and to achieve fair market value for Federal coal, Congress should enact legislation giving eminent domain authority to coal slurry pipelines."

Each federal study that has reviewed the issue of coal pipelines since the technology has been introduced has come down on the side of coal pipelines as being environmentally sound, economic, and efficient. Study after study has demonstrated the cost savings coal pipelines could provide. However, in each hearing and in each lobbying effort, the railroads have spared no expense to utilize scare tactics fueled by misinformation and outright untruths to defeat the legislation.

Senator J. Bennett Johnston introduced S. 994, the Coal Distribution and Utilization Act of 1985, on April 15, 1985. The members of the Slurry Technology Association strongly endorse enactment of S. 994 or meaningful coal pipeline eminent domain provisions. The passage of coal pipeline legislation will have an immediate moderating effect on coal haulage rates. It will provide a marketplace regulator where none presently exists. Water language was carefully crafted by water experts, including several Senators from this Subcommittee, in the last Congress so that the water provisions adopted actually provide for increased control of a state's water.

We respectfully request the consideration of coal pipeline eminent domain provisions as a part of any legislation modifying Section 2(c) of the Minerals Leasing Act favorably voted out by this Subcommittee.

STATE OF COLORADO

EXECUTIVE CHAMBERS
136 State Capitol
Denver, Colorado 80203-1792
Phone (303) 866-2471

Richard D. Lamm
Governor

85 NOV -4

October 28, 1985

The Honorable John W. Warner
Chairman, Natural Resources Development
  and Production Subcommittee
306 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Chairman Warner:

On November 8, 1985 the Natural Resources Development and Production Subcommittee is scheduled to receive testimony on legislation to amend the Federal coal leasing statutes. In addition to the Section 3 and 7 comments that were jointly submited by the western coal state governors, I would ask that the record show and the subcommittee be advised of my support for modification of Section 2(c) of the 1920 Mineral Lands Leasing Act.

I continue to believe that the original reasons for enacting Section 2(c) are no longer present, and therefore, changes in 2(c) are necessary to allow railroads or their affiliates to bid for and lease Federal coal. In closing, I would note that modification of Section 2(c) would improve the Federal coal leasing program. The additional competition would be healthy even in today's soft market and the land management and resource planning functions at the state and local level, as well as at the Federal level, would be enhanced.

Sincerely,

Richard D. Lamm
Governor

cc: Senator William L. Armstrong
    Senator Gary Hart
    Senator James A. McClure
    Senator J. Bennett Johnson
    Senator John Melcher

Written Statement of Colorado-Ute Electric Association, Inc.

Regarding Hearing on Proposed Amendments to
the Mineral Leasing Act of 1920,
Held on November 8, 1985

Presented to the

Subcommittee on Natural Resources Development
and Production of the Senate Subcommittee on
Energy and Natural Resources

Senator John W. Warner, Chairman

by

Jerry C. Kempf
Director of Governmental Affairs

Dated: November 21, 1985

This written statement is submitted on behalf of Colorado-Ute Electric Association, Inc. ("Colorado-Ute"), a not-for-profit rural electric cooperative headquartered in Montrose, Colorado by Jerry C. Kempf, Colorado-Ute's Director of Governmental Affairs. Colorado-Ute appreciates this opportunity to give our perspective regarding some of the serious problems Colorado-Ute and other users of federal coal face under the Federal Coal Leasing Amendments Act (FCLAA) of 1975 and the Bureau of Land Management (BLM) regulations and decisions implementing the Act, chief of which are the unreasonably large federal royalty increases which are being imposed by BLM on old coal leases which pre-date the FCLAA. We ask your consideration of three proposed amendments to the Mineral Leasing Act which would help to rectify some of these problems. Copies of the proposed amendments are attached at the end of the printed version of this testimony.

First though, I would like to briefly describe Colorado-Ute. Colorado-Ute Electric Association, Inc. is a generation and transmission cooperative which supplies all the electric requirements of the 14 rural electric distribution cooperatives which own Colorado-Ute. Through its 14 member/owners, Colorado-Ute serves over 180,000 customers in service areas covering over half the land area of the State of Colorado, primarily in the rural areas of the State.

Colorado-Ute was organized by its rural electric owners so that they could obtain a reliable and economical source for their wholesale power needs. In order to achieve that goal, Colorado-Ute has constructed several large coal-fired electric generating plants in western Colorado, all of which burn coal mined from nearby surface mines. The coal for these plants is supplied under several long-term coal supply agreements, which were entered into before the mines were opened or (in one instance) expanded. Some federal coal is mined at each of these mines, and one mine is located entirely on a federal coal lease. Colorado-Ute purchases several million tons of federal coal from these leases each year.

To a great degree, it was the construction of large coal-burning facilities such as Colorado-Ute's power plants, and the commitment to long-term contracts for purchase of the coal, which enabled development of the federal coal reserves in Colorado and other places. Development of these reserves has brought substantial revenues to the federal government which would not otherwise have been realized.

It is ironic that Colorado-Ute and other coal users now find that because of their commitment to long-term contracts for federal coal they face alarming increases in coal costs due to skyrocketing federal coal royalty rates. Most of Colorado-Ute's coal contracts were entered into long before the 1976 amendments to the Mineral Leasing Act. All of Colorado-Ute's coal contracts were entered into by Colorado-Ute with the good faith reasonable expectation that federal coal royalties would have at least a fair degree of continuity. In fact, the history of royalty rate readjustments at the mine for which Colorado-Ute is now facing the largest royalty increase (from 20 cents to $3.50 per ton) shows only modest increases in the royalty rate for the federal lease, originally issued in 1924 with a royalty for surface mining of 15 cents per ton. The rate was not increased at all at the first readjustment period in 1944, and at the second readjustment in 1964 was increased to 17.5 cents, escalating to 20 cents in 1974.

Now, Colorado-Ute faces federal royalty rate increases approaching 2000 percent. Since Colorado-Ute is a not-for-profit cooperative owned by its distribution members, these increases in federal royalties are directly borne as a "hidden" federal tax by Colorado-Ute's consumers--the farmers, ranchers, businessmen and homeowners of rural Colorado. These huge cost increases are made even worse by additional costs which will occur (unless Congress acts) due to inflexible diligence requirements related to the unduly restrictive definition of a "logical mining unit", and royalty reduction policies which unfairly discriminate against utilities such as Colorado-Ute with long-term coal supply contracts.

I would like to briefly explain each of these problems--the royalty increases, the "logical mining unit" definition, and the royalty reduction provisions--in a little more detail, and also to explain the solutions Colorado-Ute supports for each problem.

I. Royalty Increases

The first and foremost problem facing Colorado-Ute is the severe financial impact caused by readjustment of the royalty rate on coal leases issued before 1976 to the 12 1/2 percent minimum rate first established for new leases in 1976.

In 1976, Congress amended the Mineral Leasing Act of 1920, (the Act) to require a minimum federal royalty of 12 1/2 percent of the value of the coal (8 percent for underground mines). The Report language which accompanied the 1976 Amendments, P.L. 94-377, stated "a minimum royalty of 12.5 percent of the value of the coal is placed on all new leases, except underground mines" (emphasis added).

Without addressing whether 12 1/2 percent is the proper figure for new leases, it seems abundantly clear that the intent of Congress was not to bring pre-1976 leases under this new law. However, the BLM has interpreted this as requiring the 12 1/2 percent rate for both new and older leases as mandatory. Although a federal court (in the FMC Wyoming Corp. case) has ruled that the 12 1/2 percent rate cannot be automatically imposed when older leases are readjusted, BLM continues to order the 12 1/2 percent royalty rate into effect for many leases which predate the 1976 amendments.

This includes the federal lease (issued in the 1920's) for the Colowyo mine which supplies Colorado-Ute with the coal for Craig Station at Craig, Colorado. The increase to the 12 1/2 percent rate at the Colowyo mine amounts to nearly a 2000 percent increase (from 20 cents per ton to $3.50 per ton), and will result in additional royalty expenses to our consumers in excess of five million dollars per year. If other federal coal leases used by other coal suppliers are readjusted in a similar fashion, the total increased royalties to Colorado-Ute's consumers will be seven million dollars per year (in current dollars) by 1989. These huge increases were not expected at the time long-term coal contracts were entered into. And because of standard pass-through royalty provisions in these contracts, the result will be higher costs for Colorado's rural electric consumers. These costs may go even higher as state and private lessors seek to increase their royalty rates to match the increased federal rates.

Colorado-Ute is not alone in this problem. Tri-State Generation & Transmission Association, Inc., a part-owner of two Colorado-Ute operated power plants, is another Colorado-based REA wholesaler which faces millions of dollars of increased federal royalty costs each year. Salt River Project, of Arizona, is also a part owner of three plants in Colorado operated by Colorado-Ute and faces multi-million dollar royalty cost increases. The Public Utility Commission of Texas is on record as opposing the increase to a 12 1/2 percent royalty on these old leases as well, citing increased costs to the Texas-based Central Power and Light Company of $4 million per year for federal coal purchased from a Colorado supplier.

In October of 1984, Colorado-Ute received a letter from the Colowyo Coal Company in response to the BLM's readjustment of the royalty rate. This letter stated that the royalty component of our adjusted base price will increase from 0.952 cents per million Btu to 17.088 cents per million Btu. The BLM subsequently rejected Colowyo's protest to this readjustment. This action has recently been appealed to the Interior Board of Land Appeals.

Fairness should dictate that royalty readjustments for pre-1976 leases should be in accordance with the language of the original leases, which allow periodic reasonable royalty readjustments, when warranted by materially changed conditions. Colorado-Ute has suggested in a previous statement to the House Subcommittee of Mining and Natural Resources (Interior Committee) that royalty or rental adjustments for leases issued before the 1976 amendments should be subject to a definite limit. We have drafted a proposal which suggests an increase of not more than 200% for each readjustment period. Even a 200% increase in royalties may be unconscionable in light of the after-the-fact nature of such increases with respect to long-term coal contracts such as Colorado-Ute's. However, a 200% increase is certainly preferable to a 2,000% increase today, or perhaps an even larger increase when other pre-1976 leases are readjusted later.

In order to implement this proposal, Colorado-Ute supports the following amendment to the Act:

Delete the period at the end of the last sentence in existing 30 USC § 207(a), and add the following language:

"; PROVIDED THAT NO ROYALTY OR RENTAL READJUSTMENT MADE AFTER AUGUST 4, 1976, FOR A LEASE ISSUED BEFORE SUCH DATE SHALL RESULT IN AN INCREASE OF MORE THAN 200 PERCENT FOR EACH READJUSTMENT PERIOD."

The full language of § 207(a), with the existing language shown in lower case and the proposed addition set forth above shown in capital letters is shown in Exhibit A to this testimony.

Other witnesses before this Subcommittee have suggested other approaches to royalty rates for pre-1976 leases. Colorado-Ute has opposed a 10 year phase-in of these leases to the full 12 1/2 percent rate because it would simply result in a rapid phase-in of what we consider to be totally unconscionable rates. Colorado-Ute's consumers will still be facing increased "hidden" federal taxes on their electric bill due to 2000 percent royalty increases. We believe that a 200 percent cap, at each readjustment, on such royalty increases will provide a very generous increase in federal royalties, but is not so large as to totally destroy the reasonable expectations of rate continuity held by the long-term contract customers for such coal.

The Western Energy Company's suggestion that royalties should be based only on the non-tax portion of the coal price is certainly meritorious. This suggestion should be considered for percentage-based royalty rates, regardless of whether the percentage used is 12 1/2 percent or not. The current method of percentage royalty assessment results in double, triple, quadruple, etc., taxation - a situation which is worsened every time a new tax is added or an existing one increased.

Colowyo Coal Company has testified in support of allowing pre-1976 leases to be readjusted only as necessary to "meet materially changed conditions". Such a provision could, if properly implemented by BLM, go a long way to reduce the problems discussed above. However, given BLM's attitudes and decisions regarding these pre-1976 coal leases, Colorado-Ute would remain concerned that BLM may still seek to impose unreasonably large royalty increase, leaving the coal lessee and its customers with the prospect of protracted litigation regarding whether conditions had changed sufficiently to justify the rate increase. Colorado-Ute does not oppose the Colowyo proposal, but continues to believe that it is essential to place a reasonable cap (200 percent) on the size of royalty increases, so that this issue can be finally resolved.

II. Royalty Reductions

The second major problem facing Colorado-Ute and its coal suppliers is that the provisions of Section 39 of the Mineral Leasing Act (30 USCS § 209) which permit the Secretary of the Interior to waive, suspend or reduce rentals and royalties, have, as stated by the judge in the FMC Wyoming case, been given "sparing use (if at all)" by the BLM. Under current policy, the BLM will not even consider making royalty reductions at the time of lease issuance or readjustment, but only upon subsequent application. Under draft royalty reduction guidelines currently under review by the BLM, such reductions would only be allowed if the mine operator can show zero profit or a loss. Royalties which are passed through to contract customers must be included in lease revenues, and therefore would be excluded from the loss calculation. No consideration would be given at all to the effect of the passed-through royalties on a not-for-profit utility such as Colorado-Ute, and its consumers.

These guidelines would discriminate against coal users and suppliers with royalty pass-through provisions in their coal contracts, because a producer selling on the spot market might be able to obtain relief, while other producers in identical circumstances, except that they can pass their royalty increase on to an electric utility and its customers, would be denied relief.

The royalty reduction provisions at 30 U.S.C. § 209 were adopted as part of the original 1920 Act. When the amendments to the Act were adopted in 1976, proponents of the amendments repeatedly defended the new 12.5 percent royalty rate for new leases by emphasizing that the power of the Secretary of Interior to waive, suspend or reduce royalties under § 209 was unaffected. For example, Rep. Roncalio noted that the "[Secretary] can cut the royalty down to whatever he wishes".

Despite the clear expressions of Congress' intent, the BLM has made the royalty reduction provision of the Act virtually useless. Because BLM has refused to implement § 209 in any meaningful way, Colorado-Ute believes it would be helpful to revise § 209, to specify that relief can be provided for both pre-1976 and post-1976 leases, that it can take place either at the time of lease issuance or readjustment or thereafter, that it can be for a term up to the next readjustment, and that economic hardship, including a price to coal customers higher than fair market value, shall be considered.

Colorado-Ute suggests renumbering existing 30 USC § 209 as § 209(a), then adding new subsection (b) as follows:

"WITH RESPECT TO COAL LEASES, THE SECRETARY MAY TAKE ACTION UNDER THIS SECTION, REGARDLESS OF WHETHER THE LEASE WAS ISSUED BEFORE, ON, OR AFTER AUGUST 4, 1976. ANY SUCH ACTION MAY BE TAKEN AT THE TIME OF LEASE ISSUANCE OR READJUSTMENT, OR THEREAFTER, UPON APPLICATION BY THE LEASE HOLDER. SUCH ACTION MAY PROVIDE RELIEF FOR A TERM UP TO THE NEXT LEASE READJUSTMENT DATE. IN DETERMINING WHETHER TO GRANT RELIEF UNDER THIS SECTION TO THE HOLDER OF A COAL LEASE, THE SECRETARY SHALL CONSIDER, IN ADDITION TO THOSE FACTORS ENUMERATED IN SUBSECTION (a) HEREOF, ANY ECONOMIC HARDSHIP WHICH WOULD OTHERWISE RESULT TO THE COAL LEASE HOLDER, OR TO ANY CUSTOMER OF SUCH COAL LEASE HOLDER, INCLUDING WHETHER THE IMPOSITION OF HIGHER ROYALTIES WOULD RESULT IN A PRICE TO ANY SUCH CUSTOMER HIGHER THAN FAIR MARKET VALUE."

Exhibit B shows the revised version of 30 U.S.C. § 209, adding this proposal to the existing language.

III. Logical Mining Unit

The last major problem Colorado-Ute faces is due to the Act's restrictive definition of a "logical mining unit", which requires that all tracts be contiguous. This requirement may cause Colorado-Ute's consumers a one-time expense of up to several million dollars (the coal supplier estimates a cost of $6.5 million), and substantial additional operating expenses at the mine supplying Colorado-Ute's Hayden Station. If the current definition stands, Colorado-Ute's coal supplier has informed us of a need to move a dragline and commence mining during 1986 on a nearby, but non-contiguous tract which would otherwise not logically need be mined for several years to come, solely in order to satisfy the diligence requirements under the Act. This is so even though the coal involved is contractually dedicated for delivery to Hayden Station and clearly will be mined.

In this case, the strict requirement for contiguity in logical mining units does nothing more to assure that the federal coal is actually mined, but it will result in needless expenses and duplicative efforts.

Senator Wallop's bill (S.B. 570) deals with this problem by simply deleting the requirement that leases be contiguous. Colorado-Ute supports such an amendment to the Mineral Lands Leasing Act.

Summary

A number of bills have been introduced proposing amendments to the Mineral Leasing Act. Most of them deal with the Act's provisions for termination of new leases for which diligence has not been shown within ten years, and the bar against issuance of any new federal mineral leases to persons who hold any federal coal lease for which diligence is not proven within 10 years after the coal lease was issued or the date of the 1976 amendments. These are problems which Colorado-Ute believes Congress should consider and resolve.

However, the legislative proposals that Colorado-Ute has seen do little or nothing to solve the serious problems that the users and consumers of federal coal face under the present law. Unless the Act is amended, Colorado-Ute's rural electric customers will be forced to pay exhorbitant royalty increases, with no realistic opportunity for royalty reductions. Agricultural consumers, already reeling from the withdrawal of Federal aid to agriculture, will be further penalized as royalty increases result in increased costs for pumping water to irrigate crops and other agricultural uses.

As the cost of federal coal increases due to royalties, the already depressed coal industry will lose even more customers for federal coal, to both other domestic and foreign sources. These royalty increases will also adversely affect Colorado-Ute's ability to compete in a highly competitive energy market place. They could cause Colorado-Ute to substantially reduce its future purchases of Federal coal. In short, increased royalties on Federal coal are grotesquely distorting the economics of our long-term contracts for Federal coal. Colorado-Ute entered into such contracts with the expectation of reasonable continuity in the Federal royalty provisions.

In order to realize that expectation, Colorado-Ute and its consumers need help from this Subcommittee and from the rest of Congress. Your consideration of amendments in the three areas discussed above - royalty increases, royalty reductions, and logical mining units - is appreciated.

EXHIBIT A

30 USCS

§ 207. Conditions of lease

(a) Term of lease; annual rentals; royalties; readjustment of conditions. A coal lease shall be for a term of twenty years and for so long thereafter as coal is produced annually in commercial quantities from that lease. Any lease which is not producing in commercial quantities at the end of ten years shall be terminated. The Secretary shall by regulation prescribe annual rentals on leases. A lease shall require payment of a royalty in such amount as the Secretary shall determine of not less than 12 1/2 per centum of the value of coal as defined by regulation, except the Secretary may determine a lesser amount in the case of coal recovered by underground mining operations. The lease shall include such other terms and conditions as the Secretary shall determine. Such rentals and royalties and other terms and conditions of the lease will be subject to readjustment at the end of its primary term of twenty years and at the end of each ten-year period thereafter if the lease is extended; PROVIDED THAT NO ROYALTY OR RENTAL READJUSTMENT MADE AFTER AUGUST 4, 1976, FOR A LEASE ISSUED BEFORE SUCH DATE SHALL RESULT IN AN INCREASE OF MORE THAN 200 PERCENT FOR EACH READJUSTMENT PERIOD.

EXHIBIT B

30 USCS

§ 209. Suspension, waiver, or reduction of rents or royalties to promote development or operation; extension of lease on suspension of operations and production

(a) The Secretary of the Interior, for the purpose of encouraging the greatest ultimate recovery of coal, oil, gas, oil shale, phosphate, sodium, potassium and sulphur, and in the interest of conservation of natural resources is authorized to waive, suspend, or reduce the rental, or minimum royalty, or reduce the royalty on an entire leasehold, or on any tract or portion thereof segregated for royalty purposes, whenever in his judgment it is necessary to do so in order to promote development, or whenever in his judgment the leases cannot be successfully operated under the terms provided therein. In the event the Secretary of the Interior, in the interest of conservation, shall direct or shall assent to the suspension of operations and production under any lease granted under the terms of this Act, any payment of acreage rental or of minimum royalty prescribed by such lease likewise shall be suspended during such period of suspension of operations and production; and the term of such lease shall be extended by adding any such suspension period thereto. The provisions of this section shall apply to all oil and gas leases issued under this Act, including those within an approved or prescribed plan for unit or cooperative development and operation. Nothing in this section shall be construed as granting to the Secretary the authority to waive, suspend, or reduce advance royalties. (Feb. 25, 1920, ch 85, § 39, as added Feb. 9, 1933, ch 45, 47 Stat. 798; Aug. 8, 1946, ch 916, § 10, 60 Stat. 957; June 3, 1948, ch 379, § 7, 62 Stat. 291; Aug. 4, 1976, P. L. 94-377, § 14, 90 Stat. 1091.)

(b) WITH RESPECT TO COAL LEASES, THE SECRETARY MAY TAKE ACTION UNDER THIS SECTION, REGARDLESS OF WHETHER THE LEASE WAS ISSUED BEFORE, ON, OR AFTER AUGUST 4, 1976. ANY SUCH ACTION MAY BE TAKEN AT THE TIME OF LEASE ISSUANCE OR READJUSTMENT, OR THEREAFTER, UPON APPLICATION BY THE LEASE HOLDER. SUCH ACTION MAY PROVIDE RELIEF FOR A TERM UP TO THE NEXT LEASE READJUSTMENT DATE. IN DETERMINING WHETHER TO GRANT RELIEF UNDER THIS SECTION TO THE HOLDER OF A COAL LEASE, THE SECRETARY SHALL CONSIDER, IN ADDITION TO THOSE FACTORS ENUMERATED IN SUBSECTION (a) HEREOF, ANY ECONOMIC HARDSHIP WHICH WOULD OTHERWISE RESULT TO THE COAL LEASE HOLDER, OR TO ANY CUSTOMER OF SUCH COAL LEASE HOLDER, INCLUDING WHETHER THE IMPOSITION OF HIGHER ROYALTIES WOULD RESULT IN A PRICE TO ANY SUCH CUSTOMER HIGHER THAN FAIR MARKET VALUE.

NATIONAL WILDLIFE FEDERATION
1412 Sixteenth Street, N.W., Washington, D.C. 20036-2266 (202) 797-6800

Statement of
David Alberswerth
on behalf of the
National Wildlife Federation
before the
Senate Subcommittee on
Natural Resources Development and Production
regarding
S. 372, S. 570, and S. 913

November 8, 1985

Mr. Chairman and Members of the Subcommittee, my name is David Alberswerth and I am the legislative representative for the Public Lands and Energy Division of the National Wildlife Federation. The National Wildlife Federation represents 4.5 million Americans who care about the wise use of our natural resources. The management of the nation's coal-bearing lands has been of long-standing concern to the Federation and its members and supporters. Federally-owned coal resources underlie nearly 100 million acres of the nation's land. These same lands contain some of this country's finest remaining natural areas, wildlife populations, archeological sites, and other irreplacable resources.

The Federation viewed the passage of the Federal Coal Leasing Amendments Act (FCLAA) and the Federal Land Policy and Management Act (FLPMA) as constructive and positive steps to end the widespread abuses in the federal coal leasing program prior to 1976. Today, the Subcommittee is considering legislation intended to resolve what has been purported to be several problems with that legislation. It is the view of the National Wildlife Federation that these proposals are unwise.

Passage of the Federal Coal Leasing Amendments Act of 1976 initiated a number of significant reforms in the federal coal management program. Among the most important of these are the following: land use planning must precede the issuance of new federal leases so that environmentally-sensitive areas can be screened out before development commitments are made; sales must be by competitive bidding so that fair market value is received for federal coal leases; a 12-1/2 percent royalty rate is mandatory to ensure a fair return from the production of federal coal; and leases must be diligently developed to discourage speculation and introduce a measure of predictability so that potential impacts upon the environment and local communities can be anticipated. We believe that all of these reforms were necessary. Taken together, they help to ensure that the development of federal coal reserves is both economically and environmentally sound.

Diligent Development

We believe that diligent development provisions which impose a clear obligation upon lease holders to produce coal within a definite time period are an essential part of these reforms. Diligent development provisions serve the public interest in helping to ensure a fair return for the public's resources, discouraging speculation in federal leases, limiting the extent of public lands dedicated to coal production to reasonable levels, providing predictability so that state and local governments can more effectively mitigate the impacts of coal development upon local communities, and reducing the risk of serious environmental harm in the western coal regions.

Diligent development requirements were not an innovation of the 1976 law. The 1920 Mineral Lands Leasing Act also required the diligent development of federal coal leases. However, the Department of the Interior never effectively enforced the provisions of the 1920 law, and it was not until more than 50 years later, 1974-75, that the Department of the Interior proposed regulations that defined diligent development and set time limits for performance.[1] Nevertheless, all leases in existence today were issued under a statute which required diligent development, a condition which the current lease holders knowingly accepted. In fact, many of these leases included a specific requirement for minimum production by the sixth year of the lease term.[2]

Section 3 of FCLAA

The Congress, in enacting FCLAA, recognized that the Department of the Interior historically had not enforced the diligent development requirements of the 1920 Mineral Lands Leasing Act. Although the Department of the Interior had drafted and finalized regulations which required diligent development from all pre-1976 leases by 1986, the Congress nevertheless incorporated an additional provision into FCLAA -- Section 3 -- to ensure that action would finally be taken.[3/]

Section 3 of FCLAA prohibits the Secretary of the Interior from issuing federal leases to any lessee who has held a lease for ten years (after the passage of FCLAA) without producing coal in commercial quantities. This provision is a non-discretionary obligation. It is not subject to the same degree of uncertainty as the enforcement of Section 7 of FCLAA through lease cancellation proceedings.[4/]

Congress acted with foresight when it incorporated Section 3 into FCLAA. Since that time, the Department of the Interior has reneged on its commitment to enforce diligence on the pre-1976 leases. Due to the regulatory changes of 1982, holders of these leases now have until ten years past their next lease readjustment to meet the diligence requirements of FCLAA. The production rate which these lease holders are required to meet has been reduced from 2-1/2 percent of the lease reserves to 1 percent of the "logical mining unit reserves."

There is no doubt that the holders of these pre-76 leases have failed to diligently develop their holdings. They have had ample time to bring these leases into production. The Department of Energy Office of Policy, Planning and Evaluation's analysis of the lead times for production from federal coal leases concluded that a typical western mine required 5.5 years to start production, and 7.5 years to achieve full production.[5/] Their examination of actual OSM records in 1981 showed that small mines required at most 4.4 years to start production, and large mines 6.5 years.[6/] Mr. Harry Perry's evaluation submitted to the National Coal Association notes that available data indicates that full production requires a seven year lead time, and when unpredictable delays are considered about nine years is required.[7/] Notably, the existing regulations require substantially less than full production be achieved.

An examination of the leases which the Office of Technology Assessment (OTA) classifies as "undeveloped" shows that the average holder of a currently "undeveloped" pre-1976 lease has had 28 years to meet the now minimal production requirements. By the effective date of Section 3, these lease holders will have had on average 29 years to bring these leases into less than full production.

Last year, the Congress considered legislation similar to S. 570 which effectively repeals Section 3. The repeal of Section 3 would have given the average lessee until 1999 to achieve even minimal production -- 40 years from the issuance date of the lease.[8/]

The Federation expressed to Congress its concern that repeal of Section 3 would have sent a clear signal to industry that diligent development provisions would never be enforced, and be tantamount to repealing diligence requirements entirely. To Congress' credit, it held firm and refused to be swayed by the lobbying of the few coal firms which stood to benefit from this proposal.

The Federation is, however, concerned that there may be legitimate problems with the Department of the Interior's administration of the diligence provisions of the law, and perhaps some coal lease holders who have fully complied with the intent of Congress could be unfairly penalized. The presentation of Mobil Oil Corporation appeared to document such a unique case.[9/]

The Federation is awaiting the results of an analysis of the effects of Section 3 under preparation by the Congressional Office of Technology Assessment. We believe that such detailed information is essential to any congressional consideration of this statutory provision. It is unfortunate that this Subcommittee does not have the results of OTA's study prior to its consideration of the sweeping changes proposed in S. 372, S. 570, and S. 913.

Diligence and Public Policy

There are sound reasons for maintaining and enforcing diligent development requirements. The Federation believes that diligence requirements improve resource management. However, the principles of common law and standard business practices also support diligence.

For example, the Surveys and Investigations Staff of the House Appropriations Committee concluded:

> "The coal industry does not bear its share of the cost or risk of holding Federal coal leases. If markets do not materialize for a particular leaseholder's coal within the time allowed, that leaseholder should not reap the benefits of holding the lease until markets do materialize. Private concerns certainly do not operate this way. The leaseholder should be aware of the risks imposed by diligence requirements in his business decision to lease in the first place. If markets fail to materialize and companies cannot fulfill the diligence requirements, it is not the Federal Government's

responsibility to provide relief to the leaseholder and completely subsidize the risk by not requiring diligent development, and permitting the lessee to hold the lease and to acquire others."[10]

Diligent development requirements are in our view an example of where sound businesslike management of the public's resources is also sound resource management.

Diligence and Resource Management

Diligent development requirements are also a critical element of resource management because they determine in large part whether the policy of the federal government will be to lease for production needs, or to lease for inventories and stockpiling. In effect, they define how large the "inventory" of leases will be. In our view, allowing increased "inventories" of federal coal leases would undermine multiple-use management of the public lands and increase the risk of significant environmental damage, without producing any countervailing public benefit.

While some individuals in the coal industry would prefer to have "perpetual" leases issued by the federal government, the Federation believes that the current requirements for diligent development within a fixed time-frame are essential to sound resource management. The status of claims under the 1872 Mining Law are a good example of the results of issuing "perpetual" mineral rights. Today, despite limited production of minerals from the public lands, more than 20 million acres are under permanent claim.

Without effective diligence requirements, the acreage of public lands dedicated to coal production would undoubtably grow significantly and lands once leased for coal development, are not managed for their other resource values. The Bureau of

Land Management, for example, excludes lands leased for coal development from its "multiple-use management" prescriptions. It has been the Federation's experience that these lands are not managed for their wildlife, recreational, and other values once they are dedicated to mineral development.[11/]

Expanding the acreage held for future coal production provides little, if any, benefit for the public or the economy. Increased coal "inventories" will not increase coal production, provide new jobs, or increase the "royalties" received by the Federal Treasury and the States. Nor does it appear that holding large reserves of federal coal are essential to a successful mining operation.[12/]

Increased Environmental Risk

The Federation does not believe that the federal government should act like a monopolist and restrict supplies to raise prices. The coal needed to fuel our utility boilers, meet our export needs, supply our steel mills, and the like should be made available for development.

However, we recognize also that opening vast areas of public lands to coal development prematurely carries with it significant risks for environmental damage.

Adverse cumulative impacts from development are now becoming evident in several western coal regions.[13] The large number of undeveloped leases complicates effective planning for new leasing in these areas.

It is also clear that several of the non-diligent pre-1976 leases have significant site-specific environmental conflicts. In part, this is due to the fact that the majority of these leases were issued before the enactment of the National Environmental Policy Act, the Surface Mining Control and Reclamation Act, and the Federal Land Policy and Management Act. For these leases, there was generally no review of potential environmental impacts.

Some of these leases should never have been issued, given the severe adverse impacts their development would pose to other resources. Others should have included specific conditions in the lease to ensure that the necessary protections were recognized by the lessee and would be enforceable by the surface management agency. Section 3 provides an opportunity to correct these mistakes for such leases.

On several occasions, conflict between conservationists and industry over development of pre-1976 lease blocks has occurred. Controversy over the impact of mining on National Parks in Utah, wilderness areas in New Mexico, air quality in North Dakota, and widlife in Colorado are some notable examples. Yet, a cursory review of pre-1976 leases finds other potential problems.

One undeveloped mine block in Southwest Wyoming, for example, poses significant conflicts with wildlife resources and soil conservation. According to the Department of the Interior's own analysis, development of this area would result in "major" adverse impacts on fish and wildlife habitat, fish and wildlife carrying capacities, game and fish populations, and bird populations. In addition, the revegetation of this area is considered to be "difficult." Severe climatic conditions, strong winds, and low precipitation make successful revegetation problematic.

Another undeveloped coal lease in the same area poses risks to major raptor populations. Golden eagles, kestrels, marsh hawks, and prairie falcons predominate on the lease tract, and a conservative estimate suggests the loss of 500 raptors from development of this mine. In addition, this mine site is largely critical deer winter range.

The extent to which pre-1976 "undeveloped" federal coal leases pose site-specific environmental conflicts is unknown. OTA estimates that only a small percentage falls into this category.[14/] The BLM estimates that over 60 pre-76 leases likely to be subject to Section 3's penalty pose "severe" environmental problems. FEISS, Vol. 2, pg. A-530. However, it is difficult to make this determination with any accuracy since the Department of the Interior has exempted existing leases from application of "unsuitability" screening during its ongoing land-use planning.[15/] Therefore, for the more than 200 undeveloped leases no thorough examination of their potential environmental conflicts has been conducted, nor is one likely to be conducted until development commences or the leases revert to the Federal government.

We will not be able to avoid all of the potential impacts of coal development in the West. However, we can avoid some of these potential problems by managing our coal resources wisely. To the Federation this means making available the coal resources which our Nation needs (with careful pre-lease screening for environmental conflicts), but restricting excessive speculation and stockpiling of lease tracts, thereby avoiding unnecessary and premature commitments to development and mining. Diligent development requirements are indispensible if this objective is to be accomplished.

In addition, enforcement of diligent development requirements will relieve the pressure to open up new areas to leasing and mining. Non-diligent lease holders may be able to sell (assign) their lease to another company which is willing to develop it diligently. Otherwise, they may relinquish the lease to the federal government which can then decide whether or not to re-offer the tract in a competitive lease sale. In either case, the Department's ability to plan for new lease sales will be enhanced since the uncertainty about the large number of outstanding undeveloped leases will be reduced.

The Present Proposals

Last year, just over 100 of the more than 500 pre-1976 federal coal leases were in production. The federal coal under lease is clearly in excess of the current and projected future market demands. In 1976 Congress concluded that large tracts of federal coal were being held speculatively, and that the diligent development provisions of the law were being ignored by both the Department of the Interior and lessees. Though there have been significant increases in the production of western coal since passage of the Federal Coal Leasing Act Amendments in 1976, Congress today faces a virtually identical situation. But today, this Subcommittee is considering legislation with a very different response to similar problems. Instead of enforcing diligence, the proposals before this Subcommittee would relax diligence provisions and largely eliminate the most effective diligence enforcement provision of the 1976 law -- Section 3.

In our view, such action is unwise and should be rejected by this Subcommittee. Several specific problems with the proposals before this subcommittee should be noted. Each are examined below.

Section 2 of S. 570 repeals of the heart of the Act's prohibition on the acquisition of federal leases by those who have violated the Act's diligent development provisions:

The proposal to limit application of Section 3 to pre-1976 leases fails to recognize the uncertainty of enforcing Section 7 of FCLAA. Section 7 requires cancellation of the lease through the Courts. This procedure is vulnerable to the prosecutorial discretion of the U.S. Attorney's office and protracted and expensive litigation. As the representative of Utah International stated before the House Mines and Mining

Subcommittee in 1982, "many leases in this situation may well feel compelled to litigate the issue."[16/]

Section 2(a)(2)(A) of the Mineral Lands Leasing Act is clearly an effective enforcement mechanism. It not only avoids possible discretionary abuse by the Secretary of the Interior, but ensures that in most cases the diligence requirements of the law will be taken seriously by coal lease holders.

S. 372 and S. 913 limit the application of Section 3 to coal leases only:

Limiting the leasing prohibition only to coal leases would undermine the effectiveness of this enforcement provision. The outcry from holders of non-diligent leases demonstrates the effectiveness of this penalty. Moreover, the limitation to "coal" leases only, when combined with the other provisions of this Section, results in negating the policy objectives of Section 3 entirely.

S. 913 limits the prohibition on issuing new leases only to delinquent lessees to "competitive" coal leases:

The exclusion of "non-competitive" leases from the prohibition of Section 3 would prove an enormous loophole. It is possible that a majority of the new leasing in the next two decades will be "maintenance" tracts, given current market conditions. Most of the coal leases issued in recent lease sales have been "maintenance" tracts issued to existing mining operations where only one bidder was interested in the tract or tracts offered. The provision would vitiate the existing statute.

Section 2 of S. 372 exempts lease holders from the proposed diminished penalties of Section 3 if they "turn-back" an old lease, pay an additional rental on a new lease, or relinquish all non-diligent leases:

This idea has been called the the "turn-back" provision. It is also appropriately known as the "status quo" provision. It would exempt several large lease holders from Section 2(a)(2)(A) of the Mineral Lands Leasing Act if they relinquish equivalent non-diligent acreage for any new leases desired. This "turn back" process may well take several decades. For example, one corporation with many undeveloped federal coal leases currently holds some 52,000 acres of leased land. In the past ten years, this corporation has purchased four new coal tracts having a combined total acreage of 4,598 acres (one of which has since been assigned to another company). Based on this performance, it would take between 114 and 179 years to complete a "turn back" of all the undevloped properties currently held.

Moreover, this provision will benefit the holders of a large number of non-diligent leases. It may give them a competitive advantage in new lease sales and possibly create a new market for the sale by assignment of their non-diligent leases.

Other than complete relinquishment of all leases, firms holding non-diligent leases would now have two additional options -- to "turn back" a non-diligent lease for a new lease or pay an additional rental on the new lease.

A lessee wishing to retain its only non-diligent lease for development and still obtain a new lease in a competitive sale would be at a significant disadvantage in bidding against a lease holder with a lease which it will readily relinquish.

Section 3(a) of S. 372 and Section 6 of S. 570 would extend the ten-year diligence requirement to at least 20 years, with the payment of minimal advance royalties which can be credited against future royalty payments:

The problems of this "advance royalty" approach are that it fails to provide an adequate financial incentive to develop the lease, could result in some lessees delaying production start-up, and could in fact make enforcement of diligence provisions more difficult and complex.

These provisions would impose an escalating payment of the 12-1/2% royalty on the basis of increasing small fractions of recoverable reserves. From year 11 to year 20 of the lease term, the basis of this royalty increases from 0.1% to 1.0% of the recoverable reserves in the lease. This proposal would result in a total ten-year increase in the lessee's payments to the Federal government of 5.5%. It is quite possible that the increased value of the lease holding will exceed inflation by more than this amount. The President of Pittsburgh & Midway Mining Company reported to the Subcommittee on Mines and Mining in 1982 that since 1976, "the value of Western coal lands has risen dramatically."[17/]

Furthermore, both bills provide that these payments can be credited againt future production royalties, diluting further whatever production "incentive" may have been intended by the proposal.

The "escalating" royalty may also provide an unintended incentive to delay the start-up of production from a new mine or lease, due to the disparity in the payment required in this provision and "advance royalties" paid in lieu of continued operation. If markets or contracts are uncertain, a lessee may choose to delay production, since the payment required after the commercial quantities threshold is reached is significantly greater than this "escalating payment."

Finally, the advance royalty approach complicates diligence enforcement by increasing the financial stakes of the lease holders. In the future, non-diligent lease holders facing cancellation will not only complain about the loss of their bonus bid and investment in the property, but also the loss of their "advance royalty" investment.

We oppose these provisions of S. 570 and S. 372.

Section 6 of S. 570 and Section 3 of S. 372 repeal the requirement for submittal of an operation and reclamation plan within three years of lease issuance:

Enactment of these proposals will further erode the requirements for diligent development of federal leases. During the House's debate on the passage of FCLAA in 1976, Representative Mink -- one of the Act's sponsor's -- described the purposes for requiring submittal of a mining plan within three years: "Timely development of a lease would further be ensured by requiring the lessee to submit an operation and reclamation plan within three years of lease issuance."[18/]

During its consideration of this provision, Congress reviewed the same arguments which are before this Subcommittee today. It concluded that a three-year period was adequate and, moreover, that setting an initial deadline for submittal of this plan was inextricably related to the diligence requirements. We oppose the repeal of the deadline for submittal of the mining and reclamation plan.

S. 372 establishes in law the reduced production requirement implemented by former Secretary Watt by defining "commercial quantities" as 1% of recoverable reserves:

The Department, in deciding to reduce "commercial quantities" from 2-1/2% to 1% of the recoverable reserves of the lease, provided no justification or analysis supporting this decision. In fact, this amount is significantly less than amounts representative of commercial production at existing mines.

For example, the OTA's study of mines in the Powder River Basin indicates that they produce at an annual rate of between 2-1/2% and 6% of their recoverable reserves. This proposal, to define "commercial quantities" at 1% by statute, does not represent prudent development of federal coal resources. Moreover, the production rate chosen for the definition of "commercial quantities" bears directly upon the amount of federal coal held under lease and the size of mining operations. By reducing this amount, the land which could be held under the law would more than double. This also allows existing mine operators to improve their competitive position in the coal regions, and will be anti-competitive.

Section 4 of S. 570 and Section 5 of S. 372 would authorize negotiated sales:

The provision for negotiated sales is overly vague, providing little direction to the Department and implementing no safeguards to prevent abuse. In two sentences, this legislation would implement a far-reaching new coal leasing program with significant consequences for the federal government, State and local governments, and the environment. This idea, proposed by the U.S. General Accounting Office, may have some merit, but requires much more extensive scrutiny. We hope that this provision will be rejected until further study and refinement has been prepared.

Section 5 of S. 372 prohibits the disclosure of agency coal data:

This provision is sweeping. It would require that the coal leasing program be conducted in "secret." Geologic data, accepted bids, and perhaps even royalty payments would become "confidential" information, exempt from the provisions of the Freedom of Information Act.

The absolute prohibition on the release of "any data developed by the Department of the Interior for estimating coal tract data" would make it impossible for the public, or for that matter even the U.S. General Accounting Office, to determine whether the Secretary has met his legal obligation to receive fair market value for federal coal leases.

Section 3 of S. 570 would repeal the "contiguity" requirement for logical mining units (LMUs):

We oppose this repeal, as we did duringthe 98th Congress, when the same proposal was made in S. 1634. Retention of the contiguity requirement is important because of the manner in which the diligent development regulations are administered. Under the Department's present rule, a new lease may be incorporated into an existing mining operation as an LMU at the request of the lessee. In so doing, production from the total LMU is counted toward meeting the diligent development requirement for the new lease.

If the contiguity requirement is abolished, a lessee could incorporate a new lease which is located at some distance from an existing operation into an LMU, and then claim production from an existing operation against the diligent development requirement of the new lease. This opportunity for abuse is not unlikely, given western coal development patterns. In the Powder River Basin of Wyoming, for example, Exxon has two large operations (Rawhide and Caballo) separated by about 12 miles. Likewise, AMAX's Eagle Butte and Belle Ayr mines are separated by about 15 miles. The federal coal reserve which underlies that part of the country extend in a strip which is roughly 120 miles long. It is not hard to imagine a lessee with an operation in the southern part of the strip obtaining a lease in the northern part of the strip and claiming that the totality of his holdings comprise a logical mining unit under provisions of the proposal. The situation could also arise with coal deposits separated by only a few miles.

It is important to note that the problem, which this provision was originally proposed to address, has been resolved to the coal industry's benefit in the new coal program regulations. Charles Dietrich of the American Mining Congress testified before the House Subcommittee on Mines and Mining in 1982 in support of an identical provision in H.R. 5895. In his testimony Mr. Dietrich argued for this provision stating:

> "An LMU may consist of federal and non-federal lands, but the statute now requires that all lands in the LMU must be contiguous, or touching. The concept of contiguity was originally intended to ensure that leases in an LMU would not be separated by great distance, so that production from one remote lease in an LMU could not be credited to other leases in the LMU to satisfy production requirements. Yet in practice, legal separations such as rights-of-way and physical separations such as oxidized or eroded areas of seams and pinchouts, destroy contiguity."[19/]

This problem has been resolved by the rulemaking of 1982. To quote from the "Determination of Effects of Rules" which accompanied the revised regulations:

> "The term "LMU" has been redefined to remove the implication that all land within an LMU must be underlain by coal.... Redefining LMU allows coal beds that are interrupted by burn lines or such legal separations as rights-of-way to be included in one LMU, thus ensuring that a single operation could mine all portions of the recoverable coal reserves because more coal can be included in an LMU. The existing definition...could have forced an LMU boundry to be the line of separation within the coal bed...."[20/]

The current definitions of "contiguous and "logical mining unit" therefore read:

> "Contiguous means having at least one point in common, including cornering tracts. Intervening physical separations such as burn or outcrop lines and rights-of-way do not destroy contiguity as long as legal subdivisions have at least one point in common."[21]

> "Logical Mining Unit (LMU) means an area of land in which the recoverable coal reserves can be developed in an efficient, economical, and orderly manner as a unit with due regard to conservation of recoverable resources and other resources. An LMU may consist of one or more federal leases and may include intervening or adjacent lands in which the United States does not own the coal reserves. All lands in an LMU shall be under the effective control of a single operator/lessee, be able to be developed and operated as a single operation, and be contiguous."[22/]

The only purpose which can be served by Section 3 of S. 570 is to allow existing lease holders to incorporate widely separated tracts into Logical Mining Units in order to avoid enforcement of diligent development requirements.

Recommendations

While these legislative proposals ask this Subcommittee to undermine the diligent development requirements of the law, it is our belief that Congress should more properly consider whether the Department of the Interior is effectively implementing existing law, and whether there are legitimate cases where lessees could be unfairly penalized.

Since completion of the EIS for the Federal Coal Management Program in 1979, the Department has often considered taking the necessary actions which would resolve many of the uncertainties facing industry. However, six years later, little progress has been made.

Despite the reluctance of the Department to implement diligence requirements, or to enforce them, the Federation recognizes that there may be lessees who, though complying fully with the intent of Congress, still could be unfairly penalized. We hope that the study being conducted by the Office of Technology Assessment, and the work of this Subcommittee, will identify and examine these unique problems.

It is not possible, however, to propose a specific legislative resolution of this issue without a better and more detailed understanding of such legitimate problems. Moreover, the Federation is not convinced that legislation is entirely necessary. In the few cases which appear to have legitimate problems, it is our opinion that the Department of the Interior has the flexibility to resolve them under the existing law.

Conclusion

In conclusion, we continue to support the enforcement of diligent development provisions for all federal coal leases.

We oppose the provisions of S. 570, S. 372, and S. 946, and urge this Subcommittee to retain the provisions of the existing statute.

We encourage this Subcommittee to examine the extent of legitimate problems with the administration of the law; and, by doing so, determine whether any statutory amendments are, in fact, necessary. We believe that the study being conducted by the Office of Technology Assessment will assist this Subcommittee in this undertaking.

NOTES

1 *An Assessment of Development and Production Potential of Federal Coal Leases*, Office of Technology Assessment, Washington, D.C., December, 1981, (hereafter referred to as OTA, December, 1981), page 239.

2 OTA, December, 1981, page 247.

3 Statement of Representative Mink, Congressional Record, August 4, 1976, H8312. *See also*, Memorandum M-36951, February 12, 1985, from the Solicitor, U.S. Department of the Interior, to the Assistant Secretary - Land and Minerals Management.

4 OTA, December, 1981, pages 247-8.

5 U.S. Department of Energy, Office of Policy, Planning and Analysis, 1980.

6 U.S. Department of Energy, Office of Policy, Planning and Analysis, 1981.

7 Hearing before the Subcommittee on Energy and Mineral Resources of the Committee on Energy and Natural Resources, United States Senate, on S. 1634, October 18, 1983, S. Hrg. 98-659, page 69.

8 NWF staff analysis based upon OTA working lease list (OTA, December, 1981, pages 409-439) and response by David Houston, DOI, to question A-6 of Chairman Jim Weaver, Subcommittee on Mining, Forest management and Bonneville Power Administration, June 2, 1983.

9 Testimony of Lynn Walker, Counsel, Mobil Oil Corporation, before the Subcommittee on Mining, Forest Management and Bonneville Power Administration, June 21, 1984.Mobil Testimony

10 A Report to the Committee on Appropriations, U.S. House of Representatives on the Coal Leasing Program of U.S. Department of Interior, Surveys and Investigations Staff, April, 1983, page 90.

11 Lands leased for coal development are subject to "mitigation" requirements, but other uses of these lands are not likely to be enhanced or developed until mining is completed. Moreover, leased lands have been excluded from application of the unsuitability criteria, as discussed in the Federation's comments on the Draft Environmental Impact Statement Supplement for the Federal Coal Management Program, May 9, 1985.

12 While a few corporations hold extensive lease tracts, the majority of lessees hold less than 3 federal coal tracts. Furthermore, the largest producer of federal coal is the Decker Coal Company, which holds only 4 federal leases, and given approval of a logical mining unit, would be producing from all of its properties.

13 Environmental Protection in the Federal Coal Leasing Program, Office of Technology Assessment, May, 1984, pages 19-20.

14 OTA, December, 1981, page 6.

15 compare 43 C.F.R. 3461.4-1, 3461.4-2 (1979) and 43 C.F.R. 3461.4-2 (1982).

16 Testmony of Charles Dietrich, Senior Counsel, Utah International Inc., before the Mines and Mining Subcommittee, June 10, 1982, page 6.

17 Testimony of Richard M. Holsten, Jr., President, Pittsburg and Midway Coal Mining Company, before the Subcommittee on Mines and Mining, June 10, 1982, page 10.

18 122 Congressional Record 428 (January 21, 1976).

19 Testimony of Charles Dietrich on behalf of the American Mining Congress before the Subcommittee on Mines and Mining, Committee on Interior and Insular Affairs, U.S. House of Representatives, on H.R. 5895, June 10, 1982.

20 "Determination of Effects of Rules," May 3, 1982.

21 30 CFR 211.2(a)(8)

22 30 CFR 211.2(a)(22)

TESTIMONY ON SECTION 3 OF THE FEDERAL COAL LEASING AMENDMENTS ACT OF 1976

Before

The Subcommittee on Natural Resources Development and Production

Committee on Energy and Natural Resources

U. S. Senate

November 8, 1985

Submitted by

Michael R. Bowlin, President

ANACONDA MINERALS COMPANY

My name is Michael R. Bowlin, and I am the President of Anaconda Minerals Company, a Denver-based operating division of Atlantic Richfield Company. I am pleased that you scheduled this hearing to review the current situation with Section 3. I wish to submit the following testimony on behalf of Anaconda Minerals Company.

Anaconda Minerals Company operates coal mines in Utah, Wyoming and Colorado. Each of our operating mines is currently mining at least one federal coal lease. We hold no federal leases that are not either producing or are part of a producing mine. However, we still have potential Section 3 problems. As a result, we welcome this opportunity to express our views on Section 3, which if not repealed, could force companies such as Anaconda with producing mines on federal leases to relinquish their leases and place in jeopardy the millions of dollars we have spent to develop these public coal resources. We urge that you consider a legislative solution to the Section 3 dilemma we and other good faith operators face.

West Elk Coal Company, a subsidiary of Atlantic Richfield, is currently operating the Mount Gunnison underground mine located in Gunnison County, Colorado, just east of the town of Somerset. We hold three federal coal leases totalling more than 7,000 acres and more than 3,700 acres of private coal. All three federal leases were issued prior to 1976. To get a better picture of our situation at the Mount Gunnison Mine, I invite your attention to the map attached as the last page of my testimony.

We began acquiring a land position in the area in the late 1960's and are continuing to obtain necessary coal and surface acreage. We started our permitting work in 1976 and began construction of the mine in late 1981. We commenced mining in 1982 and produced 131,000 tons. In 1983 we produced approximately 330,000 tons, and in 1984 approximately 500,000. Our estimated production in 1985 is 600,000 tons and in 1986 will be 1,000,000 tons per year.

We have currently invested $45 million in the Mount Gunnison Mine, including $35 million in permanent surface facilities, such as silos, a state of the art loadout, conveyors and crusher. By 1986, we anticipate our investment at Mount Gunnison will total $50 million. In addition, we estimate we will have expended $60 million in operating expenses, much of which will be spent in the local community. There should be no doubt that we are committed to mining at Mount Gunnison over the long term.

Congress passed Section 3 in part to eliminate speculation in coal reserves. I think it's fair to say that it has been effective in its original purpose. There is little or no evidence of attempted speculation in new leases, and for older leases (pre-1976), Section 3 will induce some leaseholders to seriously consider the relinquishment of their non-producing leases. However, Section 3 reaches beyond its intended targets and threatens to unfairly penalize good-faith coal operators. As I have previously stated, West Elk Coal Company will have expended approximately $110 million on its operations by 1986. By the

August 1986 deadline for compliance with Section 3, we will have produced over 2,000,000 tons of coal, with executed contracts to deliver several million more tons over the next decade. Clearly by no stretch of imagination could West Elk be considered a speculator which has not made a diligent effort to develop its leases. Yet, as a result of Section 3's inflexibility, West Elk could suffer the same sanctions designed for use against coal lease speculators. I say this with the understanding that the Department of the Interior has released its own diligent development guidelines for Section 3 and Logical Mining Unit (LMU) guidelines that it hopes will ease the burden of Section 3 compliance. We appreciate Interior's efforts, but our analysis of the proposals convinces us that a legislative solution is still required.

My understanding is that Section 3 requires production of commercial quantities of coal from each pre-1976 lease prior to August 4, 1986. The term commercial quantities is not defined in Section 3 but is defined in the coal leasing regulations as "one percent of the recoverable coal reserves or LMU recoverable coal reserves". Assuming for the purposes of this discussion that this is a correct statement of Section 3's production requirement, West Elk must produce one percent of its recoverable coal reserves in each separate lease by August, 1986, or form an LMU prior to that date and produce one percent of the LMU recoverable reserves.

If you look at the map again, I think you will begin to appreciate our frustration with the entire Section 3 issue. Our three federal leases at Mount Gunnison are represented by the yellow, green and blue areas, respectively. Now as I'm sure you recognize, the design and permitting of an underground coal mine are complex activities that call for precise engineering skills and decisions. In addition to obvious demands for safety and protection of environmental quality, the economics of production enter into all decisions. In addition, the difficult mountain topography we encounter at Mount Gunnison complicates all of these problems. We had a mine plan approved in 1981, which among other things, called for a logical progression of mining on the federal leases first in the green area, then in the yellow, and finally in the blue lease. After mining takes place by advancing through the various leases, the mine plan then provided for retreating back through the mined area to pull pillars and otherwise produce coal left unmined the first time for safety and other reasons.

Our original, permitted plan would have us mining over one percent of the total reserves from the entire mine plan area prior to 1986, but we would not have commenced actual operations on the blue lease until after that date. Among other things, the State is requiring completion of subsidence studies of the surface over much of the blue lease, prior to commencing actual mining.

When last year's legislative efforts stalled, we changed our mine plan, and went about the time-consuming and expensive task of re-permitting, simply to ensure that we would begin mining in the blue lease and mine one percent of its reserves prior to next August 4. We expect to succeed, although at some financial cost. In addition, there could be less coal mined overall, which would be a waste of public resources. The point is, in our case these costs are unnecessary costs, because the purpose of Section 3 was to eliminate speculation, and not to force less logical and more costly mining practices.

Despite these extraordinary measures, we're not even assured of success yet. We are currently studying internally whether or not we should make a submission of an LMU application. Last year, we didn't know with any certainty whether LMU production would constitute Section 3 compliance. Now Interior's Section 3 and LMU guidelines assure us it will. But, of course, there is always the possibility of lawsuits challenging their validity. In fact last May at a House oversight hearing chaired by Representative Rahall, both the industry and environmentalist witnesses suggested that the guidelines should be changed to regulations. The environmentalist stated very explicitly that one reason was that lawsuits could be filed immediately, and that upon completion of legal proceedings the regulations would have the force of law. Of course, he failed to mention that those lawsuits typically take years to complete, and that doesn't do us much good in meeting the deadline for Section 3.

To summarize where we are now, we expect to comply with Section 3 at Mount Gunnison, but at some cost. We have a backup means through LMU formation, but we're not sure we can get one approved in time. I think you can begin to see why we keep pushing for legislation. But that's not the whole story. We're still left with more uncertainty in the future. I can say positively that Atlantic Richfield does not like to see that uncertainty, because the effect of making a wrong decision is, as far as we can tell, a permanent ban on future oil and gas, as well as coal leasing. I'm sure you can appreciate the rather difficult choices that leaves us with.

We have several problems with interpretation of Section 3 compliance. The first problem is determining the recoverable reserves. In 1976, the Bureau of Land Management provided West Elk a rough estimate of the recoverable coal reserves contained in our federal leases. At the time these estimates were made, coal that was produced from the area was selling for approximately $35 per ton. Unfortunately, today's market price is under $20 per ton. This price reduction very significantly impacts the amount of coal that is commercially recoverable. Accordingly, Section 3 production requirements should be significantly lowered to reflect the realities of the coal market. However, to date that has not happened. In addition, we have been discussing with the State of Colorado the question of what coal may have to be left in the ground to deal with potential subsidence problems. These discussions are likely to continue, and the estimate of recoverable reserves will change as well. In other words, we don't know how much coal we would have to produce to meet the production requirements.

Our second problem has to do with the recently issued Section 3 guidelines, which are unclear on the question of whether one percent of reserves must be "produced" prior to August 4, 1986, or whether the lease must be "producing" on August 4. Again, a look at our map will explain our problem. If we mine through the yellow and green, and are in the blue, do we have to divert workers and machines on August 4 to produce some coal from already mined areas? Remember, we don't mine out all the coal when we're advancing -- we leave some for retreat, largely for safety reasons.

A third area of uncertainty is the legal status of the guidelines themselves. Since they have not gone through the rigorous rule-making process - including lawsuits - there are and will be questions about their legal status. I don't want Atlantic Richfield to be placed in the position of bidding on future coal, oil and gas leases while being uncertain about whether the guidelines we're basing our Section 3 compliance on are valid. I don't want ARCO's future programs held hostage to some obscure interpretation of a potentially non-binding guideline. More importantly, Atlantic Richfield won't allow me to force it into that situation.

Our final concern has to do with the LMU guidelines. We were asked last year, when we testified about our problems at Mount Gunnison, why we didn't simply form an LMU. Recall, until publication of the guidelines, we weren't even sure LMU production counted for Section 3. The act itself says nothing about that. In the guidelines, there is a section that deals with the consequences of a future failure of an LMU. LMU's can fail for a variety of reasons - among them failure to mine out the remaining reserves in 40 years and complying with a host of other requirements. Interior proposes to treat such a failure in the future as a failure of the underlying, individual leases.

In the context of Section 3, consider what that could mean. We could form an LMU at Mount Gunnison to ensure compliance with Section 3. By being in compliance, we could bid on future coal, oil and gas leases. Now assume that, 30 years from now, our LMU fails for a totally unrelated reason. Interior proposes to look back at our individual leases. Did we perform all of the acts on each individual lease - the yellow, green and blue - by the appropriate time to comply with Section 3, as if no LMU had been formed? If not - the Section 3 sanctions would be imposed. Presumably that would mean invalidating any leases obtained in the interim. Would it also mean that any minerals produced would have to be returned to the ground, or compensation paid? I don't know how far this takes us, but I'm sure my parent company doesn't want to be placed in that situation.

If Section 3 is not made more certain legislatively, we may have no choice but to relinquish a lease - the blue one - which is part of an operating mine.

We are currently one of the largest employers in Gunnison County. By 1986 we expect to employ approximately 180 people. We are also one of the largest taxpayers in Gunnison County. If we relinquish one of our leases we will have to scale back our mining operations which will reduce the mine life by as much as 25 years. This results in a negative impact on our investment for this operation because we have designed equipment and facilities for a larger mine. There will be, of course, a loss in jobs and tax payments to the county. We would also suffer a severe financial loss if any of the lease's reserves had been committed to a coal sales agreement. The federal, state and local governments would also lose out on production royalties and taxes.

Section 3 was enacted to prevent speculation and to ensure the timely development of federal coal leases. Section 3's poorly defined and inflexible production requirement encumbers a good faith coal lessee's ability to logically develop its federal coal leases from both an operational and economic perspective. In fact, we question whether anyone will benefit from rigid application of Section 3 to federal coal leases under development by a good faith lessee such as West Elk. If West Elk relinquishes a potentially non-complying lease to meet Section 3, we will lose the millions of dollars we have invested in developing the lease together with the loss of the potential for marketing the coal reserves. The government will lose millions of dollars of production royalties and will be left with valuable coal reserves which will, in all likelihood, not be developed in the foreseeable future. If West Elk does not relinquish a lease which may be non-complying only in the strictest technical sense, then it, and its sister subsidiaries and divisions, could be precluded from obtaining any additional coal or on-shore oil and gas leases or could even have them issued and later rescinded. This result would also cause the government to lose potential lease developers with the soundest operational and financial capabilities.

All of this results from a perceived need to "end speculation" in federal coal leases - a problem which no longer exists. Consequently, I urge you to amend Section 3's leasing proscription.

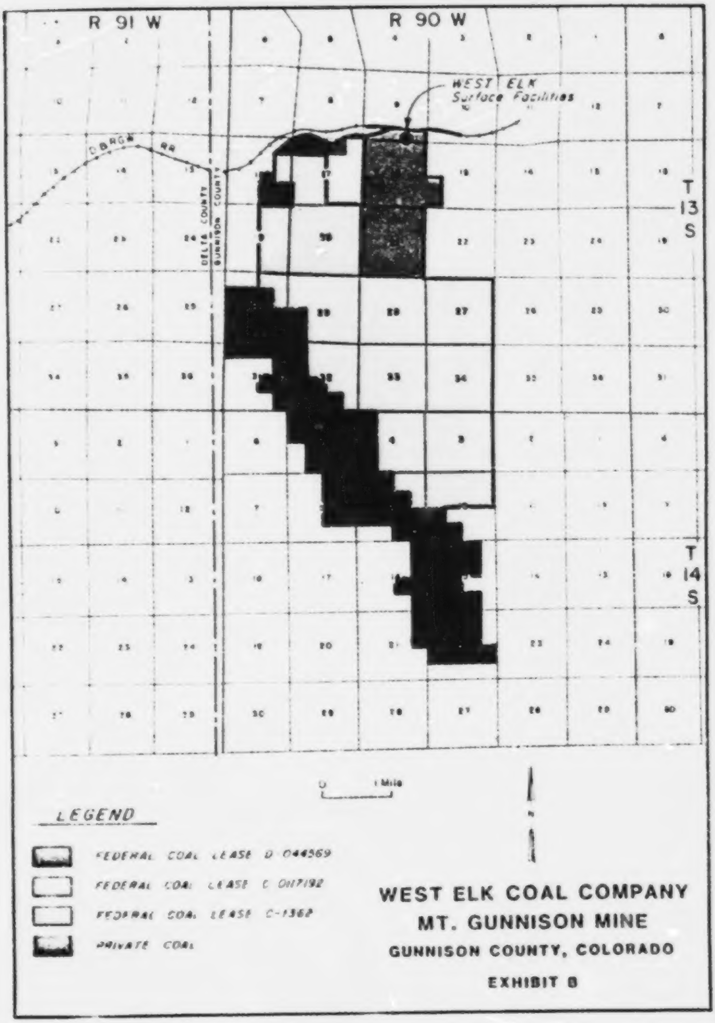
We support S. 570, which would repeal Section 3. I understand there is some support for a proposal to limit the leasing proscription to new coal leases only. I support that concept as well, because in terms of future oil and gas leasing, it would remove the sword hanging over our heads, and make our decisions that much easier. Any legislation that would amend Section 3 to eliminate the uncertainties I've described, would probably be acceptable. We would have to study any such proposal before supporting it. The critical need is to eliminate the uncertainty we face in trying to comply.

We additionally believe that any corrective legislation should clarify the definition of "commercial quantities" by recognizing the efforts of a good faith operator to develop a mine on its lease or leases. In this regard, we recommend the definition of production in "commercial quantities" should include either/or both of the following:

1. The mining of coal and/or the entry into arms-length contracts for the delivery, within 10 years, of coal constituting one percent of the commercially recoverable coal; or

2. The significant expenditure of funds for planning, development and construction of operating facilities for mining on a lease or leases in a mine plan area. The determination of what constitutes a significant expenditure could be made by the Secretary of Interior.

Again, I thank you for this opportunity to present our views.


R 91 W
R 90 W
WEST ELK
Surface Facilities
D&RGW RR
DELTA COUNTY
GUNNISON COUNTY
T 13 S
T 14 S
0
1 Mile
LEGEND
FEDERAL COAL LEASE D 044569
FEDERAL COAL LEASE C 0117192
FEDERAL COAL LEASE C-1362
PRIVATE COAL

WEST ELK COAL COMPANY
MT. GUNNISON MINE
GUNNISON COUNTY, COLORADO
EXHIBIT B

OCT 30 1985

STATE OF WYOMING
OFFICE OF THE GOVERNOR
CHEYENNE 82002

ED HERSCHLER
GOVERNOR

October 15, 1985

The Honorable Morris K. Udall
Cannon House Office Building
Washington, D. C. 20515

Dear Representative Udall:

On behalf of the State of Wyoming and the governors of the other major federal coal producing states of Colorado, Montana, New Mexico, North Dakota and Utah, I am writing to convey our common position on amendments to the Mineral Leasing Act affecting federal coal leases. We have watched with considerable interest the proposals for amending Section 2(a)(2)(A) and Section 7 of the Act.

We offer the following suggestions as you proceed.

Section 2(a)(2)(A) should be modified to remove unnecessarily restrictive provisions; however, a substantial incentive should be retained to develop pre-1976 coal leases or relinquish them. Specifically, the current prohibition on acquiring any new federal noncoal mineral lease should be eliminated. Any holder of a noncomplying federal coal lease should be permitted to acquire new coal leases only if he pays a holding fee. The holding fee should be not less than one cent per ton per year for the recoverable coal held in noncomplying leases.

Proposals to permit the turn back of some noncomplying leases as a qualification for acquiring a new federal coal lease should be rejected.

Regarding proposals to change the current diligent development provisions (Section 7), we would support extension of the current ten year diligence requirement for new leases, provided that the lessee pay a nonrecoupable holding fee which escalates each year beginning in the eleventh year. The holding fee should not be less than one cent per ton of recoverable reserves per year.

We oppose the "significant expenditure" provision as an alternative to levying a holding fee for a noncomplying lease. The proposed "significant expenditure" test would be difficult to administer, let alone enforce. It does not take into account varying mine sizes, does not distinguish between surface and underground mines, or type of coal, which all have a significant impact on determining what is a real significant expenditure and commitment to mine the leased property. Based on previous experiences with Department of Interior programs, we see this provision being subjected to constant dispute and endless litigation, and therefore, should be rejected.

Revenues generated by the extension of diligence (Section 7) or modification of Section 2(a)(2)(A) should be distributed in accordance with other mineral leasing receipts pursuant to Section 35 of the Mineral Leasing Act of 1920, as amended.

Proposals to reduce the statutory royalty rate imposed upon lease readjustment should be rejected. It would be inefficient and unfair for certain pre-1976 lessees to continue to pay a lower royalty rate than other lessees.

We support provisions that would mandate that upon the lease readjustment date, pre-1976 leases will be automatically readjusted to the royalty and diligence conditions applicable to new leases. We also recommend that when a holding fee pursuant to Section 2(a)(2)(A) or Section 7 is instituted, the lease should be rewritten to reflect all current statutory and regulatory requirements.

While we understand the interest in applying a simple test to insure that fair market value is received for new leases, proposals to require that there be at least two bidders before a lease can be sold are unworkable. Landowner configurations and large capital requirements for new mines will naturally limit bidding on a parcel. If the Department of the Interior does a responsible job in determining fair market value, the Treasury will receive the compensation due from the lease, and the public interest will be served.

Proposals that the Interior Department examine the effect of the coal lease on historical coal markets should be rejected. This type of nonsensical bureaucratic exercise is inappropriate in the federal leasing program.

The requirement that a lessee file a mine plan within three years of lease issuance should be eliminated. The Surface Mining Control and Reclamation Act currently requires a mine plan and permit approval before production can begin.

We do not oppose modifications of the requirement that logical mining units be contiguous, but would urge caution to insure that such modifications do not undermine diligence requirements. Additionally, Congress should leave to the courts the decisions on the timing of the application of the diligent development requirement for pre-1976 leases.

Finally, we believe that a stable and workable federal coal leasing program is vital to the interests of our states and the nation. Our experience indicates that states, acting through regional coal teams and through direct secretarial-gubernatorial consultation, contribute to the stability of the program and can temper the wide swings in the federal government's leasing policy which we have experienced in the past several years. We also believe that state participation in leasing decisions helps to build the cooperative relationship necessary to insure that coal which is leased can comply with environmental and socio-economic requirements that may otherwise preclude development.

We strongly recommend that any coal leasing legislation codify the role of the states in the leasing program, as found in the charters for the regional coal teams and Interior Department regulations. We have attached suggested language accomplishing this objective.

Sincerely,

EH/wwt

Enclosure

cc: The Honorable Richard D. Lamm
The Honorable Ted Schwinden
The Honorable Toney Anaya
The Honorable Norman H. Bangerter
The Honorable George A. Sinner

THE MINERAL LEASING ACT IS AMENDED BY ADDING:

"At the request of the Governor(s) of the state(s) in each coal region containing significant deposits of coal owned by the federal government, the Secretary shall establish a joint Federal-State team which shall guide all phases of federal coal leasing procedures and serve as a forum for resolving regional conflicts involving coal leasing. The responsibilities of the teams shall include guiding the delineation of potential lease tracts, ranking and selecting tracts and alternatives to be examined in documents required by the National Environmental Policy Act, recommending to the Secretary tracts to be offered for lease, timing of sales and lease stipulations, and evaluating the adequacy of data to support leasing decisions. The teams shall, at regular intervals, advise the Secretary on methods to improve the efficiency and effectiveness of the federal coal leasing program. The teams shall take all necessary steps to inform the public of pending decisions, to solicit the views of the public and to respond to comments received. The Secretary shall accept the recommendations of the team except in the case of an overriding national interest or in the case that he accepts the advice of the affected state governor(s) pursuant to this section. If the Secretary does not accept the recommendation of the team, the Secretary shall publish in the Federal Register his reasons."

"As part of the development of programs to lease oil shale or tar sands under this Act, the Secretary shall establish joint Federal-State teams with authorities and responsibilities comparable to those for coal leasing."

"Before determining whether to conduct a coal, oil shale or tar sands lease sale, lease exchange, modification of lease terms, royalty reduction, or lease transfer, the Secretary shall seek the recommendation of the governor(s) of the state(s) in which such lease(s) or potential lease(s) is located as to whether or not to take such proposed action and what alternative actions are available and what special conditions could be added to the proposed lease(s) to mitigate impacts. The Secretary shall accept the recommendations of the governor(s) if he determines that they provide for a reasonable balance between the national interest and the state's interest. The Secretary shall communicate to the governor(s) in writing and publish in the Federal Register the reasons for his determination to accept or reject such governor's recommendations."

Exxon Coal USA, Inc., Statement
Submitted to the Subcommittee on Natural Resources
Development and Production
Committee on Energy and Natural Resources
United States Senate
November 8, 1985

Exxon Coal USA, Inc. appreciates this opportunity to comment on S.570, S.372, S.913, and S.946.

Exxon Coal USA entered the coal business on a grassroots basis in the mid-1960's. The Company purchased its first coal reserves in 1965 and opened its first underground mine in Illinois in 1970. That year the Company ranked 258th in U.S. coal production. The Company opened its second underground mine in Illinois in 1977. Exxon Coal USA acquired its first federal coal leases in 1967 in the Powder River Basin of Wyoming and opened the Rawhide Mine north of Gillette in 1977. The Company opened the Caballo Mine south of Gillette in 1978. Since beginning operations, the Company's Western mines alone have produced more than 58 million tons of federal coal, making Exxon Coal USA one of the leading developers of federal coal in the industry. In 1984, production from these four mines totalled more than 23 million tons, ranking Exxon Coal USA sixth in U.S. coal production.

Exxon Coal USA currently holds five federal coal leases, three at the Caballo Mine and two at the Rawhide Mine. The main lease at each mine is producing well in excess of the commercial quantities rate. However, two leases adjacent to the Caballo Mine and one lease adjacent to the Rawhide Mine are not producing. Two of these leases, one at each mine, were obtained in 1983 as part of the I-90 highway exchange authorized by Congress in 1978. The Section 3 Guidelines issued by the Bureau of Land Management, Department of Interior on August 29, 1985, indicate that these two leases will not become subject to Section 3 until 1993, when they will have been held for 10 years. The remaining nonproducing lease located at the Caballo Mine was acquired by assignment in 1975.

While all three of these nonproducing leases are adjacent to one of Exxon Coal USA's main producing leases, due to their locations within their respective mine blocks, independent coal production from these three leases before August 4, 1986 (the initial Section 3 compliance date) is far less efficient, less environmentally desirable and less economic than mining these leases in a logical sequence in conjunction with the main producing leases. After a review of existing statutory and regulatory authority, on December 26, 1984, Exxon Coal USA submitted applications to form a Logical Mining Unit (LMU) with the three leases at Caballo and to form another LMU with the two leases at Rawhide. The Caballo LMU was approved and signed on November 1, however the Rawhide LMU is still being processed, and it is uncertain when it will be approved.

Exxon Coal USA cannot expose Exxon Corporation to the Section 3 penalty which could prohibit the Secretary of Interior from issuing any new onshore federal leases covered by the Mineral Lands Leasing Act of 1920 after August 4, 1986, to Exxon Corporation if one of Exxon Coal's federal leases does not comply with Section 3. If Exxon Coal is unsuccessful in its efforts to form an LMU at the Rawhide Mine, or if Congress does not act swiftly to repeal or moderate this onerous provision, Exxon Coal may be forced to relinquish nearly 100 million tons of recoverable coal reserves. At current production rates, this could shorten the life of the Rawhide Mine by more than 10 years. Surely Congress never intended Section 3 to force a company with a proven record of developing and producing federal coal to relinquish a nonproducing lease that is within a producing mine plan area and which it plans to logically produce in the future. Also, even if the Company is successful in obtaining approval of the Rawhide LMU, the potential for litigation initiated by third parties over the Section 3 guidelines and the LMU guidelines, and the potential for future adverse changes in the guidelines, will subject companies to continuing uncertainty over Section 3 that only Congress can resolve. Exxon Coal USA urges this Committee, the Senate and the Congress to repeal or moderate this section of the Federal Coal Leasing Amendments Act of 1976 before it and other companies are forced to take actions that are not in the best interest of the energy consumers of America. Others have testified eloquently on the history of the Federal Coal Leasing Amendments Act of 1976, so Exxon Coal will not dwell on that. However, the Company would like to offer comments on legislation being considered by the Committee.

S.570

Exxon Coal has consistently supported the efforts of Senator Wallop and other members of the Senate Energy and Natural Resources Committee to repeal Section 3. Mr. W. C. Grinstead, Jr., President of Exxon Coal USA, wrote to many of you in September, 1983, supporting repeal of Section 3, and the need for repeal continues strong today.

Precluding holders of nonproducing pre-1976 federal coal leases from further federal mineral leasing is counterproductive. It could reduce the number of potential bidders for a broad range of federal leases, resulting in lower bids and a slower rate of domestic mineral development. It is inequitable in that no other federal leaseholders are faced with exclusion from future federal lease sales based on the rate at which they develop their current federal leases. In view of the existing Section 7 provision which provides for termination of pre-1976 federal coal leases failing to achieve diligent development within 10 years of the first post-1976 lease readjustment, we believe the Section 3 penalty is redundant and unnecessary.

The requirement that all pre-1976 coal leases be producing in commercial quantities by August 4, 1986, is based on an assumption that a market exists for that coal. Demand has grown far less rapidly than envisioned in 1976. The production criteria required for compliance with Section 3 are too inflexible to respond to such supply/demand fluctuations in the coal market.

Section 3 was included in the Federal Coal Leasing Amendments Act of 1976 to end what was perceived as speculation in federal coal leasing. Ironically, it would be diversified energy/mineral producing leaseholders, such as Exxon, that have the financial and technical resources to develop these federal leases, that would be among the most severely impacted by the Section 3 penalty. Many of these companies have already spent many millions of dollars to develop these leases. For these reasons, Exxon Coal USA supports repeal of this provision. The Company appreciates the past and present efforts of those who have sponsored such legislation.

Exxon Coal also would like to comment briefly on two other provisions of Senator Wallop's bill, namely repeal of the 40-year mineout provision and repeal of the requirement to file a mine plan within three years of lease issuance.

A coal producer has 40 years from the effective date of an LMU to mine out the economically recoverable coal reserves of the LMU. Based on the Company's current mine plans, it intends to meet that requirement. However, no one has any way of knowing what may happen between now and 2025. If at the end of this 40-year period, a company is employing hundreds of miners and is producing millions of tons of federal coal annually, it doesn't make much sense for the government to shut that mine down. If the mine has been producing for 40 years and most of the recoverable reserves have been mined out, where will the government find a company to come in and invest millions of dollars to mine out what's left? Exxon Coal believes that the Section 7 diligence requirements for LMUs provide the Secretary of Interior with sufficient authority to steward production of the federal mineral estate in the public interest. The Company urges you to repeal this arbitrary provision.

Exxon Coal USA also supports the provision of Senator Wallop's bill, and S.372 introduced by Senator Johnston, to repeal the requirement to submit a mining and reclamation plan for a lease within three years of the date the lease is issued. These bills still provide for the submission of a mining and reclamation plan to the Secretary of Interior "prior to taking any action on a leasehold which might cause a significant disturbance of the environment." All that is being repealed is the requirement that such a plan be submitted within three years of the time a company is issued a federal coal lease. A company needs to know who the customer will be for a mine and what the production level will be, before it can develop a realistic operation and reclamation plan. Asking a company to develop a mine plan before such information is available and asking the Department of Interior to review such a plan is a waste of time and effort for both the company and the government. Exxon Coal supports the concept that submission of the operation and reclamation plan should be required prior to the start of construction, and should not be tied to the lease issuance date.

Exxon Coal USA generally supports S.570 as introduced by Senator Wallop, but does not support amending S.570 to include provisions addressing Section 2(c) of the Mineral Lands Leasing Act of 1920. Exxon Coal does not oppose discussing the issues associated with Section 2(c). However past debate on these issues indicates that they are complex and contentious. The Company questions whether it is reasonable to expect that issues which have been debated for 60 years will be resolved in the next six to nine months. Yet the Section 3 penalties for noncompliance will become operative in less than nine months. If the debates of the past few years on the Federal Coal Leasing Amendments Act of 1976 have indicated anything, it is that the Section 3 issues are extremely complex. Adding the Section 2(c) issues to the current Section 3 debate is a sure way to further confuse deliberations on both issues and hinder the expeditious resolution of Section 3 which is so critically needed. Exxon Coal USA respectfully urges the members of the Committee to consider each issue on its own merits, rather than combining them in a single piece of legislation.

S.372

Exxon Coal has been working with other companies and associations for several years in an attempt to arrive at a legislative solution to Section 3. The Company believes repeal is the best answer. However recognizing that repeal may not be possible, Company representatives have met with many members of this Committee to discuss alternative legislative options for resolving Section 3. Exxon Coal believes that Senator Johnston's proposal represents a framework for a comprehensive solution to Section 3 which provides a reasonable approach to the development of federal coal and protects the public interest without resorting to the draconian penalties of Section 3. However, the Company has several concerns about this proposal.

This bill would limit the Section 3 penalty to federal coal leases only. This is a major step in the right direction, however the penalty is still too broad. As proposed in S.372, the penalty would prohibit the Secretary of Interior from issuing preference right lease application leases which were pending before enactment of the Federal Coal Leasing Amendments Act of 1976. It also would prohibit the Secretary from issuing alluvial valley floor exchange leases, which were mandated by the Surface Mining Control and Reclamation Act of 1977, as well as maintenance and bypass leases. Exxon Coal USA believes that continued issuance of such leases is in the public interest. For this reason, the Company supports further limiting the Section 3 penalty to "competitive" federal coal leases, as provided in S.913.

The bill also provides for the payment of an "additional rental" as a means of complying with Section 3. This could provide lessees subject to Section 3 and the government with some much needed flexibility in complying with Section 3. Such a provision could provide a lessee with the ability to make a Section 3 compliance decision based on market outlooks and economics. However limiting this compliance option to two nonproducing leases appears to be unduly restrictive. The Company recommends that this limitation be deleted from S.372.

This additional rental provision also is silent concerning the period during which the additional rental must paid. Since the additional rental is being paid in lieu of production to comply with Section 3, it follows that the period of the additional rental should be concurrent with the period of noncompliance. Once a lessee is in compliance with Section 3, the additional rental should no longer be required. This would provide an incentive to the lessee to begin producing coal on the noncomplying lease as quickly as possible. Conversely, it also would limit the period that the new lease was uncompetitive because of the additional lease payments vis-a-vis other leases as a result of the additional rental.

Section 3(a) of S.372 provides that upon the first readjustment of a pre-1976 federal coal lease, "the amount of royalty required to be paid under such lease shall be readjusted automatically by operation of law to a rate of not less than 12-1/2 percent of the value of coal for surface mined coal ...". Due to pending federal coal lease readjustment litigation, this provision could be interpreted to create a dichotomy between the appropriate royalty rate increase for pre-1976 federal coal leases readjusted before passage of the Federal Coal Leasing Amendments Act of 1985 and leases readjusted after passage of the Act. Depending on the final disposition of the issues raised in the FMC Wyoming case, holders of pre-1976 coal leases subject to readjustment before passage of this provision could have a significant competitive advantage over other pre-1976 leases readjusted after enactment of such a provision. Exxon Coal recommends that this provision be deleted.

Exxon Coal USA is concerned that Section 4 of S.372, which defines "competitive bidding" as the receipt of two or more bids for a federal coal lease, could have a major negative impact on future federal coal lease sales. Due to location, coal quality, or other considerations, a specific lease may be of interest to only one company. In fact a number of leases offered in such sales attract only a single bid. If that bid is reasonable and meets the minimum criteria established by the Regional Coal Team and the Department of the Interior, Exxon Coal does not believe the bid should be rejected solely because it was the only bid received.

S.913

As indicated in the comments on S.372, Exxon Coal USA supports a comprehensive solution to Section 3 if repeal is not possible. However limiting the Section 3 leasing penalty to competitive federal coal leases makes the penalty relate to the obligation. Failure of a coal company to have a pre-1976 federal coal lease that it has held for 10 years producing in commercial quantities should not affect the ability of affiliated companies in other businesses to obtain future federal leases for oil, gas, oil shale or other minerals covered by the Mineral Lands Leasing Act of 1920. Prohibiting such companies from competing for leases in these other areas will only reduce the number of bidders, result in lower bids and slow the pace of mineral development. If repeal or a comprehensive solution to Section 3 cannot be accomplished in the short time remaining before the Section 3 penalty becomes effective, S.913 may provide an alternative that would be a major step towards resolving this issue.

S.946

Exxon Coal USA is quite concerned with S.946 which would prohibit the Secretary of Interior from issuing a new competitive federal coal lease to any company engaged in the production and importation of coal from a foreign country. While Exxon Coal USA has established a record as one of the leading developers of federal coal in the West, Exxon Corporation, through its Colombian affiliate, INTERCOR, has been developing the Cerrejon North Block project with CARBOCOL, the Colombian government coal company.

As Mr. R. C. Kiddoo, president of Exxon Coal International, testified before the Subcommittee on Natural Resources Development and Production on June 6, Cerrejon production is expected to reach 16.5 million short tons annually by 1989. At least two-thirds of this production is expected to go to Europe. He anticipates that the remaining one-third will go to the Far East, Middle East, Caribbean, Latin America, and the United States.

Subsequent to the release of several government and consulting firm studies concerning the potential impact of coal imports in the United States, Exxon Coal recently updated and expanded its market analysis for Cerrejon coal. Based on this most recent analysis, the Company's conclusions today are basically the same as the conclusions Mr. Kiddoo cited. In the vast majority of market areas in the U.S., Cerrejon coal is not likely to be competitive with domestic coal primarily due to the cost disadvantages in transportation and handling. For these reasons, realistic customer interest in Cerrejon coal has occurred on the East and Gulf Coasts, primarily in areas remote from major U.S. coal fields, where it offers consumers the benefit of a low-sulfur, low-cost fuel for generating electricity. It is highly unlikely that U.S. steam coal imports will exceed 1% of domestic production in the forseeable future. For example, coal imports in 1984 were only 0.16% of production, and are expected to be about 0.2% of the 888 million short tons expected to be produced domestically in 1985. Imports of two-tenths of one percent do not constitute a significant threat to the U.S. coal industry.

While U.S. coal imports have been at such a low level, U.S. producers exported 81 million short tons of coal in 1984, including 24 million short tons of steam coal and 57 million short tons of metallurgical coal. Exports are expected to grow to more than 85 million tons this year. A key factor in the future growth of U.S. coal exports is reducing the direct and indirect trade barriers imposed by some European and Far Eastern countries. Progress is being made in reducing these barriers within the European Economic Community. However enacting an indirect trade barrier, such as that proposed in S.946, would send the wrong signal abroad and would only serve to strengthen the pro-subsidy, anti-import forces in European coal producing nations.

S.946 also will be ineffective. It will not stop foreign nations from developing attractive coal export projects. And it will not stop such projects from exporting coal to the U.S. market if such coal offers U.S. consumers a competitive alternative to domestic coal. However, S.946 will discourage American coal companies from competing for such international projects. Exxon Coal USA does not believe this is in the national interest. Since Exxon won the Cerrejon Project, Morrison-Knudsen of Boise, Idaho, was selected as the prime contractor to develop the mine, railroad and port. Companies in virtually every state in the U.S. have sold or received commitments for goods and services totalling more than $500 million. If legislation such as S.946 had discouraged a U.S. company from winning this project, many of these purchases, which have a positive effect of the U.S. balance of payments, may have been made elsewhere. Such a result is clearly counterproductive.

This legislation also is anti-competitive leasing policy. Denying Exxon and other coal producers who develop and import coal from a foreign country the right to participate in federal coal lease sales would restrict competition for such leases. Exxon Coal USA has demonstrated that it is an efficient developer of federal coal, providing low cost, low sulfur federal coal to electric utilities and their customers in Indiana, Iowa, Kansas, Nebraska, Oklahoma, Texas, Wisconsin and Wyoming. Exxon Coal USA has made major contributions to increase national coal production, create jobs, promote safety, and boost industry productivity. The Company believes it is in the public interest for this Committee to permit such a proven competitor to participate in future federal coal lease sales.

Conclusion

In summary, there is an urgent need for the Energy Committee, the Senate, and Congress to repeal or moderate the excessive penalty contained in Section 3 of the Federal Coal Leasing Amendments Act of 1976. If there is a need to address the Section 2(c) issue, Exxon Coal USA urges you to consider this issue on its own merits, rather than further complicating resolution of Section 3. The Company also hopes that Congress will not prohibit a major developer of federal coal, such as Exxon Coal USA, from participating in future federal coal lease sales, solely because another part of Exxon may be producing coal in a foreign country and importing a small amount of that coal for the benefit of U.S. consumers. Exxon Coal USA appreciates this opportunity to present these comments and commends the Committee for its consideration of these critical issues.

STATEMENT
OF THE
WESTERN COAL TRAFFIC LEAGUE

Before The

SUBCOMMITTEE ON NATURAL
RESOURCES DEVELOPMENT AND PRODUCTION

COMMITTEE ON ENERGY AND NATURAL RESOURCES

UNITED STATES SENATE

Hearing On S.372, S.570, S.913, and S.946
And Other Coal Related Issues

November 20, 1985

The Western Coal Traffic League (WCTL) appreciates the opportunity to submit this Statement on behalf of its members in connection with the Subcommittee's hearing on S.372, S.570, S.913, and S.946, legislation which would revisit certain key elements of the 1920 Mineral Lands Leasing Act, as amended by the Federal Coal Leasing Act Amendments of 1976.

THE WESTERN COAL TRAFFIC LEAGUE

The Western Coal Traffic League is a voluntary association of organizations whose common interest is that each is a major consumer of bituminous coal. Nearly 100 percent of the coal consumed by WCTL members comes from mines located west of the Mississippi River. The members of WCTL are listed in Appendix A to this Statement. As shown, the membership is a diverse one which includes municipalities, industrial corporations, public districts and utilities of all types. Collectively, WCTL members consume almost 50 million tons of bituminous coal annually. The lion's share of this enormous consumption comes from coal producers who are operating on federal leases which were executed prior to August, 1976. These coal purchases are made by WCTL members under long-term agreements, whose minimum terms are generally about 10 years.

POSITION OF WCTL

WCTL commends the Subcommittee for holding this timely hearing on S.372, S.570, S.913 and S.946, to re-examine the 1920

Mineral Lands Leasing Act (MLLA) in light of interpretation and enforcement experience since the most recent amendments in 1976, and current trends in coal use and public energy demands. The purpose of this Statement is to address an issue of critical importance to WCTL members and many other consumers of western coal which has arisen as a result of MLLA enforcement, though it is not yet a part of any of the bills under consideration here. The issue of great concern to WCTL is the impact on electric consumers and taxpayers of the precipitous royalty increases which are starting to be imposed in connection with coal mined from pre-1976 federal leases as a consequence of the Federal Coal Leasing Act Amendments of 1976. WCTL urges the Subcommittee to act meaningfully to remedy this serious and inequitable situation by supporting amendments to the Act to rescind, reduce, or -- at the very least -- phase-in the effectiveness of royalty increases imposed as a condition to renewal of pre-1976 federal leases.

In voicing its opposition to the dramatically increased royalty payments which have been occasioned by the Federal Coal Leasing Act Amendments of 1976, WCTL wishes to underscore that it is merely the surrogate for the millions and millions of electric customers throughout the west and mid-west who will directly absorb the increased federal royalties in their monthly light bills. Thus while it may be the so-called big oil or big energy companies who write the checks for the federal royalties to the United States of America, it is the consumer -- the customers of WCTL members -- who ultimately bear the increased expenses.

IMPACT OF INCREASED FEDERAL ROYALTIES ON CONSUMERS

As noted earlier, most coal in the west is marketed pursuant to long-term purchase agreements, which typically are written for between 10 and 30-year terms. Long-term fuel agreements are an economic fact of life in the west. This is so because of the huge capital requirements needed to construct power plants and the mines required to fuel them. In order to warrant these massive capital investments, producers must be assured of a stable, long-term market and the energy users must be assured of a reliable, long-term supply. Most long-term agreements essentially establish a starting base contract price for the coal, and a mechanism for passing through any subsequent coal production cost increases to the purchaser. In this way, the initial profit margins can be maintained throughout the life of the agreement. Under the typical western long-term coal supply contract, the federal royalty is a specified portion of the contract base price, and any and all increases in the federal royalty are automatically added to the buyer's contract base price by the producer.

Most long-term coal contracts are confidential and/or proprietary documents, and therefore their terms cannot be revealed publicly. Several WCTL members, however, are public or municipal entities, whose coal supply agreements are in the public domain. Appendix B to this Statement sets forth excerpted portions of two long-term coal supply agreements which reveal how these agreements automatically require the buyers to absorb any and all royalty increases.

Appendix B, sht. 1, is excerpted from a contract to which the City of Austin, Texas and the Lower Colorado River Authority (LCRA) are signatories. The contract section clearly reveals how the buyer's price for each ton of coal acquired under the contract is directly affected by a change in the amount of the federal royalty. The same sort of mechanism is shown in a different formulation in the coal supply agreement of the City of San Antonio, Texas in the contract excerpt reproduced as Appendix B, sht. 2.

Like the big oil and the big mining companies, WCTL's utility members in most instances pass increases in their coal prices on to the electric consumer. Most member companies operate in jurisdictions where fuel cost increases are immediately and directly added to the customer's bills. A few members must first secure regulatory permission to pass on the royalty increases. Invariably, however, whatever the regulatory arrangements are, the individual electric customer pays the royalty and the royalty increases.

ACTUAL EXAMPLES

As many Members of this Subcommittee and the entire Congress are well aware, WCTL members have had all they could handle in recent years fending off or fighting huge transportation cost increases imposed by monopolistic coal-hauling railroads. It is therefore ironic that its members are now being confronted with the increased price aspirations of a new monopolist in the west -- the United States of America. Because the federal coal is marketed in large part under the long-term agreements described above, there is no effective limitation on the amount of royalty increases which the market will bear. Thus, the United States of America, like the railroads, can charge WCTL's captive members whatever it chooses.

This phenomenon is readily apparent in the first wave of royalty adjustments which has occurred as a result of the Federal Coal Leasing Act Amendments of 1976. Two WCTL members, Central Power and Light Company of Corpus Christi, Texas, and the City of Colorado Springs, Colorado already have been visited by the rapidly emerging "federal coal royalties problem." Each has seen the royalty portion of its coal cost per ton escalate from under 25 cents to nearly $4.00 -- increases which already have been passed on to the electric consumers in their service areas. These are huge absolute increases, and they are gargantuan from a percentage standpoint -- over 1500 percent. Not even WCTL's old nemesis, the railroads, have exploited captive customers this boldly. The United States of America should carefully reconsider whether it is consistent with national energy policy and the public interest to so abruptly and so precipitously impose royalty increases of this magnitude on electric consumers.

Other WCTL members have been notified by their suppliers that similarly huge royalty increases are on the way. For example, the Amax Coal Company's federal leases which supply its Belle Ayr mine have been scheduled for major royalty increases by the Bureau of Land Management of the Department of the Interior. These anticipated increases are equally dramatic in their magnitude to the ones described in this Statement. Amax's Belle Ayr mine is a supplier to the following WCTL members:

MEMBER	SERVICE AREA
Kansas Power & Light Company	Topeka, Kansas
Kansas City Power & Light Company	Kansas City, Missouri/ Kansas
Oklahoma Gas & Electric	Oklahoma City, Oklahoma
Iowa Power and Light Company	Des Moines, Iowa
Cabot Corp. (Southwest Power)	Amarillo, Texas

Absent prompt attention by and relief from the Congress, these WCTL members and their millions of electric customers shortly will endure royalty hikes in their monthly electric costs of approximately 1,000 percent over current levels.

REASONS WHY INCREASED FEDERAL COAL LEASE ROYALTIES SHOULD BE MODERATED OR RESCINDED

The primary basis upon which the WCTL membership opposes the rash of increased federal royalties which is now being visited upon it is clearly stated above; namely, that the already beleaguered electric consumers are bearing all of the extra expenses that they can. There are, however, separate and additional compelling reasons which WCTL believes support either the elimination of the increased royalties; a reduction in the amount of the increase; or a gradual phase-in of the increases. They are:

1. Fairness

Without exception, WCTL members in the past burned huge amounts of natural gas and oil in their operations. For example, Houston Lighting & Power Company was at one time the second largest consumer of natural gas in the world. WCTL members were encouraged -- indeed, frequently compelled -- in the national interest to convert from scarce oil and gas to abundant western coal. This encouragement came largely from the federal government, which was deeply concerned over the nation's energy crisis during the early 1970s. The goal was to ensure a stable, long-term supply of domestically-produced energy at a reasonable cost. WCTL members committed billions of dollars of capital to the construction of new coal-fired plants, to fleets of railroad cars, and, in some cases, to coal mining equipment. These enormous capital outlays were made on the understanding and in reliance upon the fact that federal coal would remain available under the terms and conditions of the federal coal leases which prevailed during the early 1970s -- when they were entered into. In a sense, the United States of America, by dramatically increasing its royalties in the 1980s, is going back on the bargain which it made with large energy users in the 1970s. It is demonstrably unfair for the federal government to exploit its captive royalty payers when it was the federal government which either required or encouraged most of these same interests to consume coal in the first place.

2. Allocation Of The Royalties

It has been argued that high royalty rates are necessary in order to ensure that the taxpayers get a fair return on the value of public resources, and -- through the revenue-sharing that takes place between the federal government and the states -- to provide impact aid for the regions where the coal is produced. The first point is illusory; the second overstated.

The argument that higher royalties produce a better return for the taxpayer ignores the fact that it is the taxpayer that pays the royalty in the first place, through higher electric bills. Whatever funds go into the "taxpayers' pocket" (i.e., the federal treasury) do not come from big oil and energy companies -- they come from the same taxpayers' other pockets. Given the choice, most citizens would rather simply keep a dollar than pay it out in one form to get the same dollar back in another. Moreover, it must be remembered that only 10 percent of the coal royalties revenues come back to the federal taxpayers; the other 90 percent is instead funneled, directly or indirectly, to the producing states. So in reality, the federal taxpayers are being asked to pay out, rather than take in, a return on the coal that they own.

The second argument overlooks the fact that coal mining operations on federal leases already generate enormous revenues for the economies -- and the state and local treasuries -- of the states in which they are located. In the first place, the mines provide numerous jobs for residents of those states, and the money that those residents are able to earn and spend benefits local economies and fills local sales and property tax coffers. Moreover, each of the states where coal is mined has a sizable severance tax which is paid by WCTL members' consumers. For example, the well-known severance tax in the state of Montana is 30 percent of the value of the coal. It is the view of those members of WCTL who buy Montana coal that this severance tax is itself much too large. In view of all of the revenues that its members' coal purchases are already contributing to the economies and treasuries of Montana and Wyoming, WCTL submits that it would be fundamentally unfair to require the electric ratepayers of Texas, Oklahoma, and other coal consuming states to further cross-subsidize those producing states. When the federal government increases its royalties by 1000 percent and then turns half of those increased royalties directly over to the states, it simply adds to the serious problems already caused by excessive severance taxes.

3. Competitive Disadvantages

Events of the past year or so have begun to demonstrate that the electric consumer has had his fill with ever-escalating electric rates caused by high fuel and capital costs. The financial debacle resulting from nuclear power plant problems are notorious. Equally well known are the hardships caused by excessive rail transportation rates. Utility companies are no longer willing or able to stand idly by and pass gigantic cost increases on to their customers. As a consequence, numerous utilities are acting to relieve themselves of the burden of unfair fuel agreements. Utilities in Kentucky, Texas, Oklahoma and elsewhere, for example, have recently begun to refuse coal deliveries where the coal prices have escalated dramatically and unfairly. These disputes are now before the courts. This trend only will be accelerated if the federal government insists upon increasing its royalties by 1000 percent or more. In the long run, the federal government actually may lessen its total royalty revenues rather than increase them, if it persists in imposing high, across-the-board royalty increases without regard to the impact on individual coal users and their citizen-customers.

The irony of the situation described here is that the only real beneficiaries will be the land-grant railroads. The largest mineral owners in the west, other than the United States of America, are the same railroads which for years have contributed to the high cost of energy through supra-competitive transportation rates. The railroad leases compete directly with the leases of the federal government for development. By dramatically and arbitrarily increasing the royalty rates on its leases, the United States of America will directly benefit the railroads, who either will take similar hikes in their leases upon renewal -- further pushing up the total cost to the consumer -- or conversely will undercut the United States in competing for producer business, thus lowering federal revenues and increasing deficits.

CONCLUSION

For the several reasons discussed in this Statement -- which admittedly are but a part of the serious problems facing coal-dependent electric suppliers and users under current federal royalty policy -- WCLT respectfully urges the Subcommittee to take prompt, appropriate action through amendments to the bills now before the Subcommittee or, if necessary, expedited separate legislation, to either rescind the royalty increases called for under the Federal Coal Leasing Act Amendments of 1976, or to reduce the amount of these increases and/or to stagger their effectiveness so as to ease the burden on the electric consumers who ultimately must pay them. This Subcommittee's counterpart in the House of Representatives, the Subcommittee on Mining and Natural Resources, has already acted on this important subject. Through an amendment to Section 7 of H.R.1934, which was marked up in July, the Subcommittee calls for the phasing-in of royalty increases on pre-1976 leases over a ten-year period. At a minimum, WCTL strongly urges this Subcommittee to consider and propose legislation to grant similar relief.

Once again, WCTL appreciates the opportunity to present its views on this subject of most serious concern to its members and the millions of electric ratepayers they serve.

Appendix A

MEMBERS
WESTERN COAL TRAFFIC LEAGUE

Arizona Electric Power Cooperative, Inc.

Celanese Chemical Company

Central Power and Light Company

City of Austin

City of Colorado Springs

City Public Service Board of San Antonio

Iowa Public Service Company

Kansas City Power and Light Company

Kansas Power & Light Company

Lower Colorado River Authority

Minnesota Power & Light Company

Oklahoma Gas & Electric

Omaha Public Power District

Tucc, Inc.

Unitrain, Inc.

Utility Fuels, Inc.

APPENDIX B - SHEET 1

ROYALTY PASS THROUGH PROVISION EXCERPTED FROM CITY OF AUSTIN AND LOWER COLORADO RIVER AUTHORITY COAL SUPPLY AGREEMENT

SECTION 9.04(1) - COSTS BASED UPON EXTRACTION

The price of coal shall be increased or decreased from the base price at any time payments are made by Seller resulting from impositions which are made directly or indirectly upon the production of coal from the Mine, which are imposed on a per ton basis, such as royalty payments (including overriding royalties, advance royalties, bonus payments, and the like), payments to pension plans maintained on behalf of employees, mine license taxes, or similar payments, and where such payments are greater or less than $.635 per ton.

APPENDIX B - SHEET 2

ROYALTY AND OTHER PASS THROUGH PROVISIONS EXCERPTED FROM LONG-TERM COAL SUPPLY AGREEMENT OF CITY PUBLIC SERVICE BOARD OF SAN ANTONIO, TEXAS

CONTRACT PRICE

The contract price for each ton (2000 pounds) of coal beginning in 1977 and earlier if Buyer takes deliveries earlier, shall be comprised of the mining segment, the reclamation segment, and the capital segment.

1. MINING SEGMENT

The mining segment shall be the cost of mining coal sold hereunder which shall include the following costs of operation. The parties agree that a preliminary estimate of today's costs of these items is a total of $1.50 per ton which is composed of the following and may be distributed approximately by the percentages shown:

a.	Direct mine labor (employees and contract)	19%
b.	Supervisory and technical services at the Mine (employees and contract)	2%
c.	Payments to Welfare, retirement and similar funds	29%
d.	Materials, supplies, equipment (other than capital items), explosives, power, fuel, insurance premiums and payments for claims in excess of insurance coverage	14%

e.	Compliance with governmental impositions, licenses, fees, taxes (other than income), health, safety and environmental requirements	20%
f.	Lease rentals and royalties	13%
g.	General and administrative overhead	3%

Notwithstanding the above estimates, it is agreed that the mining segment of the price of coal hereunder for the initial twelve month period of deliveries of such coal shall be the best estimates of the actual costs of this segment of mining such coal over this period. This estimate shall be reasonably determined by Seller and based on the most recent mining study by Fluor Utah Incorporated under contract to the Seller at the time of initial delivery of coal.

The mining segment includes, but is not limited to, such expenses as those relating to road maintenance, haul road extension, surfaced road extension and power line extension (after commencement of coal deliveries); tires, belts and replacement items; coal preparation, handling and loading; and power, fuel, water, communications and utilities. Engineering and other studies required for the operation of the Mine and conducted by Seller's Corporate Staff or outside consultants directly related to the operation of the Mine shall also be considered part of the mining segment of the price.

Twelve months after initial delivery of coal under this contract, the actual cost per ton (total mining cost divided by total tons produced at the time) of items a. through f. for that period shall be calculated and item g. shall be restated as 10% of items a., b., and d. A debit or credit memorandum shall be issued so that the mining segment of the price for the year is based upon actual experience instead of estimate. Such actual experience per ton shall then be used as the estimate of the mining segment of the price for the following three months. This process of adjusting the mining segment from estimates to actual costs shall continue quarterly for the full term of the contract.

Notwithstanding the foregoing, any change in cost which, by its nature, is identified as a "per ton" cost and is included in sections c., e., or f. of the mining segment, shall be included as an increase or decrease in this segment as it is imposed or incurred.

STATEMENT
OF THE
WESTERN REGIONAL COUNCIL

SUBMITTED TO THE
SUBCOMMITTEE ON NATURAL RESOURCES DEVELOPMENT AND PRODUCTION
SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES

HEARING ON
COAL LEASING LEGISLATION

NOVEMBER 8, 1985

STATEMENT OF THE
WESTERN REGIONAL COUNCIL
SUBMITTED TO THE
SUBCOMMITTEE ON NATURAL RESOURCES DEVELOPMENTAND PRODUCTION
SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES

The Western Regional Council (WRC) is a coalition of 44 major companies active in the Western United States. Our membership includes businesses engaged in financial, energy, mining, transportation, manufacturing and other enterprises.

The purpose of the WRC is to provide a forum for the resolution of issues which uniquely affect the business community in our region and to recommend policies to State and Federal governments which recognize the need for both a healthy economy and a healthy environment in which to live.

Since it was organized in 1977, the WRC has been actively interested in the Federal coal program, working with the Congress, the Department of the Interior, and with Western Governors on coal leasing issues. Our membership includes both coal producers and users, as well as companies not directly affected by Federal coal policies. The WRC has an overall interest in a workable Federal coal program which will foster economic growth and stability in the public land states of the West.

DILIGENT DEVELOPMENT

Diligent development has been a principle in Federal coal leasing since enactment of the Mineral Leasing Act of 1920. Prior to the Federal Coal Leasing Amendments Act of 1976, payment of annual rentals met the Interior Department's diligence requirements. FCLAA mandated a 10 year diligence period. Lessees who held an undeveloped coal lease at the time of enactment were to be precluded from obtaining any further Federal leases (coal or other minerals) if production in commercial quantities was not achieved after 10 years.

The diligence and lease prohibition provisions of FCLAA were enacted in response to a perception in the Congress that Federal coal leases were being held for speculation rather than with the intent of production. Committee reports accompanying the Act cited the number, acreage, and primary holders of Federal coal leases. They inferred concentration of public coal resources in the hands of a few and expressed concern that leases could be held indefinitely without development to the detriment of the public interest.

Although Federal coal leasing was at a halt in the mid-70's, FCLAA reflects attempts by Congress to react to the repercussions of the OPEC oil embargo. There was uncertainty as to the nation's energy and financial security. Dramatic increases in petroleum prices and a series of proposed national energy plans encouraged the view that domestic coal resources provided the most viable path toward energy independence and national security. A shift to coal as our primary energy source was expected and would mean a dramatic boom in coal development and demand for Federal coal leases. The Congress moved to put in place mechanisms it felt were necessary to protect the public interest, the environment, and competition within the context of those events and projections. The time has come to re-evaluate the product of those perceptions.

FACTORS AFFECTING DEVELOPMENT

There have been numerous changes since passage of FCLAA. Additional complex legislation dealing with coal mining, such as the Surface Mining Control and Reclamation Act of 1977, has been adopted. That Act and the resultant regulations are extremely complex. Compliance with its requirements requires an operator to expend a good deal of time and effort before lease production can commence. From a decision to proceed to production, based on market considerations, it may take at least four to five years before mine construction commences. A slow market or the specifics of a sales contract may delay this process for an undetermined period. These requirements and additional lead times compound the lead times that were already understood at the time of enactment of FCLAA. Interior Department comments noted then the delays in delivery of mining equipment, an eight to ten year lead time between a decision to build a coal consuming plant and the time when coal deliveries are needed, and the nature of long-term coal delivery contracts.

1977 amendments to the Clean Air Act blocked the anticipated use of low sulfur coal, largely from western Federal coal leases, to reduce power plant emissions in the East. Questions remain about implications for western Federal coal demand from Administration and Congressional action on clean air related issues and programs. Oil and gas prices stabilized and have even declined, reducing the anticipated economic forcing of fuel switching to coal. Conservation practices and other factors slowed the aniticipated acceleration in electrical power demand and the construction of new coal fired generation capacity and coal consumption. Frustration in accurately forecasting electrical needs has added additional uncertainty in long term coal market projections. Potential export markets have not materialized to the extent some envisioned.

All of these factors and others contributed to a slump in coal markets, longer lead times in actual mine start-up, and extreme caution by coal producers in moving ahead toward production of a lease or acquiring additional leaseable coal properties. While we expect coal markets to revive, the situation demonstrates why we need some flexibility in regard to diligence.

The operator who is today charged with meeting a diligence period can be placed in an untenable position. The Department of the Interior recognized the problems involved in these kinds of circumstances when it made modifications published in July 1982 in the diligence and continued operations provisions of 43 CFR 3400. Those modifications protect the integrity of the concept of diligent development, but redefine commercial quantities to a more realistic production level. They also recognize the potentially drawn out procedural process ahead of mining by providing that the 10 year period can begin when a lease is incorporated into a logical mining unit or upon the first lease adjustment after 1976. However, the regulations were not able to make changes in Section 3 of FCLAA.

The Commission on Fair Market Value Policy for Federal Coal Leasing (Linowes Commission), in its February 1984 report, recognized many of these factors affecting development:

> (T)he Commission heard testimony that 10 years leaves little leeway for the logistics of mine development.... Moreover, additional time may be needed to negotiate a contract or assemble the coal properties and surface rights needed for a mine--and these efforts may not begin until a lease is acquired. Some unusually complex projects, such as synfuels plants, may require 10 or more years to construct. The Commission also found that the 10-year period makes no provision for unexpected fluctuations in coal markets, or other unforseen circumstances.... Given the further mechanical complexities of coal contracting, mine site assembly, and mine development, the commission found that 10 years is too short a period in which to require diligent development of Federal coal leases.

WRC POSITION

The concept of diligent development has merit in that it serves to discourage speculation and restricts leasing to persons seriously contemplating operations. The Western Regional

Council believes, though, that the public interest today can be served through this concept without the harshness required in present law.

We recommend and encourage support for two specific changes in this regard, the repeal of Section 3 of FCLAA, and allowing the payment of advanced royalties in lieu of production in commercial quantities.

Section 3

Section 3 of FCLAA prohibits the Secretary of the Interior from issuing any Federal mineral lease (oil and gas, coal, etc.) to a lessee who holds and has held a Federal coal lease for 10 years and is not producing coal in commerical quantities. Section 3 penalties would begin to apply to pre-1976 leases after August of 1986.

Section 3 will particularly affect those integrated companies with pre-1976 coal leases which are active in leasing other minerals besides coal. It may result in abandonment of some affected coal leases by these companies, reduced competition for other mineral leases, transfers of leases from companies with capabilities to mine a tract most efficiently, disruption of coal markets, and/or extensive litigation.

In a separate judgment by two of the Commissioners (the other three Commissioners recused themselves from actions concerning Section 3), the Linowes Commission report concluded that, if the advance royalties in lieu of production were adopted, "the Congress should abolish the provisions of Section 3" of FCLAA.

Section 3 is a punitive, unnecessary provision. It goes beyond reasonable production incentives and diligence requirements which adequately deter speculation and protect the public interest. It fails to recognize the many changes in circumstances described above which have occurred since enactment in 1976. It provides no flexibility to address any of the kinds of factors which have contributed to long lead times and changes in coal markets. Section 3 of the Federal Coal Leasing Amendments Act should be repealed.

Advance Royalties

The Western Regional Council believes that the public interest would be best served by allowing lessees of non-producing leases to pay reasonable advance royalties in lieu of production beginning at the end of the due diligence period if production in commercial quantities has not been achieved.

An economic production incentive beginning at the end of the due diligence period would serve as an adequate deterrent to speculation and would provide the Government with greater assurances of development. Furthermore, payment of advanced royalties would provide the Federal Government with a small revenue stream until production is achieved, as well as a financial incentive for the lessee to move toward actual production in the near future.

The Interior Department would be able to avoid costly re-leasing procedures and probably witness actual lease development more quickly than if a lease were cancelled and reawarded to another party through a re-leasing process. It is the royalties paid under a lease not the bonus bids which provide the greatest return to the Federal government. If a lease is cancelled for failure of production in commercial quantities with no opportunity for payment of advance royalties, the Government can expect no revenues from the tract unless and until it is re-leased and then royalties would not be received until and unless production actually began by the new lessee after another long lead time.

The Linowes Commission carefully considered diligent development requirements, current statutory and regulatory provisions, and potential alternative approaches to providing production incentives. In its report, the Commission expressly found that the "objective of achieving diligent development would be better met by the use of financial incentives under an advance royalty system." The U.S. Department of Interior "Review of Federal Coal Leasing", dated March 19, 1984, agreed with the Commission recommendation that the 10 year termination requirement be abolished and be replaced with "financial incentives" to produce in a timely manner.

Especially at this time when coal markets are depressed and when new laws and environmental considerations have caused a stretch out in pre-mining activities and requirements, advance royalties in lieu of production in commercial quantities makes eminent sense. The WRC recommends that Congress allow payment of advanced royalties in lieu of production rather than restricting this privilege to producing leases as is presently authorized.

OTHER PROVISIONS

There are at least two other provisions contained in previous as well as pending legislation that the Council has specifically requested. First, we believe that there are circumstances in which the tracts in a logical mining unit (LMU) should not have to be contiguous as now required. If other criteria are met (e.g. under the effective control of a single operator, able to be developed and operated as a single operation) we do not see why the requirement for being contiguous is essential. Opportunities are readily available in the LMU designation process to fully review whatever circumstances may warrant the inclusion of a non-contiguous parcel. Removal of the contiguous requirement will result in a more workable and flexible law that is better able to address unusual circumstances and specific operations.

Second, the deletion of the three year requirement in section 7(c) of FCLAA for filing an operation and reclamation plan also makes good sense. Given the many uncertainties and variables involved in coal markets and in production and environmental requirements, a three year, fixed filing deadline will more often than not result in the necessity of numerous later amendments to the plan once filed and once the lease nears the development stage. So long as the plan, as required by 7(c), must be filed "prior to taking any action on a leasehold which might cause a significant disturbance of the environment", the three year filing requirement is unnecessary and can be deleted without jeopardizing the purposes of the subsection.

CONCLUSION

The WRC appreciates this opportunity to review our position and to submit our views about the Federal coal leasing and management program, specifically regarding diligent development of Federal coal leases. As we continue to review these issues and recent legislative proposals, we will continue to keep the Subcommittee informed of our views.

/vg

STATEMENT
By the
AMERICAN PETROLEUM INSTITUTE
For the
HEARINGS ON S.372, S.570, S.913 and S.946
To
AMEND THE MINERAL LEASING ACT
Before the
SUBCOMMITTEE ON NATURAL RESOURCES DEVELOPMENT AND PRODUCTION
SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES

The American Petroleum Institute - a trade association comprised of 230 member companies, with 6,000 individual members engaged in every aspect of the petroleum industry - has a strong interest in issues arising under the Federal Coal Leasing Amendments Act of 1976 (FCLAA). No FCLAA issue is of greater concern, however, than the imposition of the Section 3 sanction which could effectively bar certain coal leaseholders (and their affiliates) from obtaining new Mineral Leasing Act (MLA) leases after August 1986. Many API members are current holders of federal coal leases and also potential participants in future federal programs involving MLA leasable minerals (coal, onshore oil and gas, oil shale, tar sands, etc.); therefore, legislative relief from this excessively punitive sanction is of vital concern. Also, the lead time required for companies to develop mineral leasing programs (especially oil and gas) and to dispose of coal leases makes it necessary that legislative action on this issue be completed soon so that adverse consequences to U.S. energy development are avoided.

THE IMPORTANCE OF COAL FROM FEDERAL LANDS

Since the 1973 oil embargo, national energy policy has recognized the important role which coal must play in meeting our domestic energy needs. The energy policies articulated by every Administration and Congress in the intervening years have emphasized greater reliance on domestic fuels, especially our most abundant domestic fuel - coal - either through burning or as a feedstock for synthetic fuels. Western coal reserves are most amenable to development in large-scale mining operations capable of supporting large electric power plants and commercial synthetic fuel projects. The federal lands in the West contain as much as sixty percent of the total western coal reserves, with a great portion of the non-federal coal indirectly impacted by federal land management policies (including, but not limited to the coal leasing program).[1/]

SECTION 3 BACKGROUND

Prior to the enactment of FCLAA, federal coal leases were subject to a diligent development requirement, but until Congress began consideration of the legislative proposals which led to FCLAA, the Department of the Interior (DOI) had not issued regulations to define diligent development. Consequently, no federal coal leases had been cancelled because of failure to comply with "diligent development." Congressional review of the status of federal coal leases in the early 1970's revealed that the majority of those leases were not being developed. The 1975 report (H. Rept. 94-681) of the House Interior Committee cited various reports and studies:

- 59 of the then-existing 533 leases were actually producing coal (U.S. Geological Survey);

- "There has been relatively little mining of federal coal deposits, and most lessees apparently have no

---

1/U.S. Department of the Interior. Federal Coal Management Report for FY 1981.

> immediate plans to begin coal mining operations."
> (General Accounting Office).

In addition, there was Congressional concern that almost half of all federal coal leases had been acquired through preference rights leasing, a non-competitive system requiring no bonus bids. Both these findings fueled popular suspicions that many federal coal leases were being acquired for speculative purposes with no intention of development. Furthermore, in the aftermath of the Arab oil embargo of 1973, allegations surfaced that large U.S. oil producers were attempting to gain monopolistic positions in coal and then suppress development of that coal.

Given this highly charged atmosphere, Congress passed FCLAA with the prime objective of forcing the development of federal coal leases. All new coal leases issued under FCLAA which were not producing in commercial quantities at the end of ten years would be terminated. (As interpreted by DOI, this ten-year production or termination requirement also applies to pre-FCLAA leases upon their first readjustment following enactment of FCLAA.) In addition to this inflexible production deadline, concern over the speculative holding of existing leases led to the additional punitive sanction of Section 3:

> "The Secretary shall not issue a lease or leases under the terms of this Act to any person, association, corporation, or any subsidiary, affiliate, or persons controlled by or under common control with such person, association, or corporation, where any such entity holds a lease or leases issued by the United States to coal deposits and has held such lease or leases for a period of ten years when such

> entity is not, except as provided for in Section 207(b) of this title (Section 7(b) of FCLAA), producing coal from the lease deposits in commercial quantities. In computing the ten-year period referred to in the preceding sentence, periods of time prior to August 4, 1976 shall not be counted." 30 U.S.C. 201(a)(2)(A).

In retrospect, not only have the 1976 suspicions and innuendoes proven to be unfounded, but the results of implementing Section 3 may well be worse than the problems thought to exist when it was enacted. Consider the statements made at the time by supporters of Section 3:

"There is too much undeveloped federal coal under lease."

The large inventory of federal lease holdings in private hands by 1970, which was thought to be one indication of speculation, was not excessive, considering the wide ranges of uncertainty regarding future demand for western coals, the variety of coals of different qualities for which reserves had to be maintained, and the requirement of reserves for a mine life of 30 years or more. Historically, the coal industry and others dependent on depletable resources for their marketable products have tried to maintain large inventories to assure long-term supplies. In this respect, the size of western federal coal reserves that had been leased by 1970 was similar to the privately-owned eastern reserves of coal, after adjusting for differences in anticipated future production rates.[2]

---

[2] Harry Perry. An Evaluation of the Selected Provisions of the Federal Coal Leasing Amendments Act of 1976. Report to the National Coal Association. Revised June, 1983.

AVAILABLE

"Oil companies would sit on coal reserves to preserve high energy prices."

In fact, oil companies have proven to be better-than-average coal developers and have not "sat on reserves." In 1975, oil firms held 22.0% of total U.S. coal reserves and accounted for 16.7% of annual U.S. production. By 1981, even though the share of coal reserves held by oil firms declined to 18.7% of total U.S. reserves, these firms were producing 21.6% of U.S. coal production. Increased production share was also true for federal leases. Oil and gas companies accounted for 47 percent of total federal coal production in 1982, a share that had increased from just 25 percent three years earlier.

"Speculators (non-developers) hold a substantial share of existing federal coal leases and Section 3 will reduce their holdings."

While coal developers need to hold large inventories of undeveloped reserves, 3/ some reserves are in the hands of lessees who are not in the coal development business.

3/ U.S. Department of Justice. Competition in the Coal Industry, December, 1982:

> "For this market to operate efficiently and competitively, it is essential that a sizeable number of competitors each have reserves that can fill a utility's needs. In addition, a successful coal company generally will need a substantial portfolio of undeveloped reserves that it can bring to negotiations with utilities. In a very real sense, coal companies perform a valuable service by speculatively holding coal reserves. Society benefits because the companies hold reserves until a match can be made with a utility, and that match may take some time."

Because Section 3 neither forces lease forfeiture nor requires production earlier than the diligence provision (ten years from the readjustment date for pre-FCLAA leases), true speculators - those who acquire and hold reserves with no intention of actually developing the reserves themselves - may well be unaffected by the Section 3 sanction. Bona fide coal developers (in particular, diversified federal mineral producers) will not be so fortunate since they - rather than speculators - will want to obtain new MLA leases.

IMPACT OF SECTION 3

The Section 3 type of punitive provision is found nowhere else in the federal mineral leasing program, nor in any state mineral leasing program, and goes far beyond any standard lease termination penalty for nonproduction of a mineral lease. Since Section 3 has been construed by DOI to bar a sanctioned leaseholder from obtaining any mineral leased under the Mineral Leasing Act, imposition of the Section 3 prohibition could potentially affect a multi-mineral developer's ability to secure new resources, the production of which is vital to the nation's economy and security. A study prepared by the late Harry Perry (see Note 2/), a distinguished mineral economist with a long career in government and who was associated with Resources for the Future, concluded that imposition of the Section 3 penalty would:

- upset the equilibrium of the western coal markets by forcing more production by a specified date than the market can absorb at that time;4/

4/As later discussion in this paper will show, the potential for forcing additional production is severely limited since the 1986 deadline will not permit a producer adequate lead time essential to bringing a coal lease not adjacent to an active mine into production.

- diminish competition for federal coal (and other mineral) leases by precluding many of the multi-mineral and coal-only producers most likely to bid on federal leases from bidding, and;
- reduce federal and state revenues by precluding development of other federal mineral resources through the elimination of competition for such resources.

EXTENT OF THE PROBLEM

Many present lessees will not be able to meet Section 3's commercial production requirement by the August 4, 1986 deadline. The reasons include the failure of a market to develop for the leased coal (either due to the less-than-anticipated demand for coal or a shift away from coals of a certain quality), the long lead times necessary to bring large mines into full production, the diminished market prospects for synthetic fuels and secondarily the lead time and construction time involved in non-mine facilities associated with synthetic fuels projects, as well as the impact of laws and regulations imposed since enactment of FCLAA (e.g., the Surface Mining Control and Reclamation Act). Recent testimony by the Department of Interior details the extent of the Section 3 problem. 5/ Of the 528 pre-FCLAA leases, DOI estimates 229 leases will not be in

---

5/ Statement of J. Steven Griles, Acting Assistant Secretary, Land and Minerals Management, U.S. Department of the Interior before the Subcommittee of Mining and Natural Resources, Committee on Interior and Insular Affairs, U.S. House of Representatives, May 21, 1985.

compliance on August 4, 1986. Of these 229 non-complying leases 101 are held by firms with oil and gas interests. Finally DOI estimates that at least 150 oil and gas companies including affiliates may be prevented from obtaining other onshore federal mineral leases after August 4, 1986, if Section 3 is left in place and applied.

Impact on federal mineral leasing programs other than oil and gas would also be substantial. A majority of firms currently involved in the four prototype federal oil shale leases hold pre-FCLAA coal leases. Many large diversified mineral companies are also federal coal leaseholders. These companies are likely to be important participants in any oil shale, tar sands, or other non oil and gas leasing program developed by DOI. These companies, therefore, are faced with the Section 3 sanction which could disrupt their synthetic fuels plans and other mineral operations in addition to their oil and gas programs.

The Section 3 sanction provides harsh treatment for those lessees who decide to retain their non-producing pre-FCLAA leases, though, it also strikes against the interests of the federal and state governments in obtaining fair market value in future leasing. The Linowes Commission report warns: "The provision of Section 3 may prevent some companies -- including a company that could mine the tract most efficiently -- from bidding on future Federal coal leases, thereby reducing competition."[6] At many competitive lease sales (whether coal, oil shale, oil and gas in a known geologic structure), there are only a handful of bidders on each individual tract, etc. If just a few firms were barred from participating at future sales, both the level of bonus bids and the number of tracts leased could fall significantly. The Department of Interior testimony suggests that a substantial number of future bidders first will have to extricate themselves from a potential Section 3 problem. The direct result of Section 3 could be reduced competition for all MLA leases and, with it, reduced future mineral production and government receipts.

---

[6] Report of the Commission, Fair Market Value Policy For Coal Leasing, February, 1984.

LEASEHOLDER DILEMMA

In the absence of repeal or substantial modification of Section 3, given the forward planning requirements of most companies, current leaseholders with a lease which cannot be brought into compliance with Section 3 are currently considering actions on the three options now available: (1) relinquish the lease; (2) assign the lease to another firm; or (3) hold the non-compliance lease and accept the consequences.

These decisions are not nine months away (the August 1986 deadline notwithstanding). Companies active in both oil and gas leasing and coal leasing are deciding now whether to continue acquiring federal onshore oil and gas leases after August 4, 1986, or to switch to other lease acquisitions. Planning and budgeting to acquire federal oil and gas leases typically takes in excess of ten months. Exploration budgeting and expenditures in support of such lease acquisition efforts are typically conducted from one to three years in advance.

Consider the options open to the lessee:

Relinquishment is permitted under regulations on condition that there is a "satisfactory showing that the public interest shall not be impaired" by surrendering the lease. This condition has not been defined by DOI, but past experience reveals that the length of time required to complete the process is highly variable. On the surface, the process seems simple: if the lease account is in good standing and all necessary reclamation has been done, relinquishment should be straightforward and finished in a few months. However, problems have been developing. Disputes over proper payments of rents, adequate land restoration, or the mining of additional coal seams on the lease are examples of problems which can drag out the relinquishment process. As the Section 3 deadline approaches, an increase in the number of relinquishments sought is likely, particularly involving leases upon which some surface activity had occurred, raising the possibility of more disputes and longer processing times. These concerns will require lessees choosing this option to act long before the August 1986 deadline, but very little time is left.

Assignment (sale and/or transfer by assignment or sublease) of the lease to another party is permitted under the MLA, subject to DOI approval. The "...holds...and has held..." language of the statute clearly indicates that the ten-year Section 3 compliance period attaches to the lessee and not to the lease, but there are uncertainties about the assignment option. Most fundamentally, assignments require two parties. Will lessees seeking to assign be able to find assignees?

Retention of the lease and acceptance of the sanction is an option few developers are likely to choose, although problems with relinquishment and assignment could leave this the only alternative. In addition, some firms with substantial investments in a particular coal lease may elect to incur the sanction for a short period beyond August 1986 until the coal lease could be brought into production. Presumably, the sanction would be lifted once the lease was producing in commercial quantities.

THE PRODUCTION OPTION

Formation of a Logical Mining Unit (LMU) may provide a solution for a few non-producing leases. However, given the uncertainties of relinquishment and assignment, and the sanction involved with retaining a lease not in compliance with Section 3, is production of these pre-FCLAA leases in commercial quantities a viable option? The answer is "no," for several reasons. Given the typical lead times required to bring a western coal mine into production, lessees would have had to start the development process by 1980 or 1981 at the latest in order to meet the deadline. But many leaseholders who expected the coal market to be strong in the late 70's and early 80's were left without supply contracts for their leases. Therefore, development activities were never begun. Even if a market for that coal exists in 1986, it would be unrealistic to assume that leases for which no or only minimal development work has been done could be producing in commercial quantities by then unless they are included in an LMU. More importantly, the long-term supply contracts now being sought by the electric utility customers for western coal call for initial delivery well beyond 1986.7/

While production potential for 1986 has been established for the most part by the development activities that have already taken place, it is interesting to conduct a hypothetical exerciseby turning the clock back to 1976. If all of these leases were brought into production by 1986 and producing in commercial quantities, there would be an additional surplus from all western mines of about 120 million tons per year in excess of projected demand. Thus, even if these leases had been brought into production to satisfy Section 3 much of the coal could not be sold.

Another interesting feature of Section 3 is that when firms bring pre-FCLAA leases into production prior to the deadline, the federal government (and the states with which it shares royalties) may collect less than if production commenced later. On most pre-FCLAA leases the royalty rate was set at 20 cents per ton on surface-mined coal and 15 cents per ton on underground coal. For pre-FCLAA leases that have been readjusted since 1976,

---

7/U.S. Department of Justice. Competition in the Coal Industry. April 1983:

> "The typical coal contract in the West is for the supply of essentially the entire fuel requirements of a single, new generating plant for at least the first twenty years of its operation. Such contracts are signed five to ten years in advance of the initial operation of the plants to allow sufficient time for the boiler to be designed and built and the plant constructed."

the government's position is that the royalty rate is 12.5 percent of mine value for surface-mined coal which could result in royalty rates up to $1-$3 per ton at current mine prices for steam coal (and even higher in the case of metallurgical coal). Thus, whenever a pre-FCLAA lease is brought into production prior to lease readjustment, the government collects less in royalties until the date the lease is readjusted. Consequently, the present value of royalties to the federal and state governments is likely to be less to the extent Section 3 has stimulated early development of some pre-FCLAA leases.

IMPACT ON SYNTHETIC FUELS

The impact of Section 3 on the development of the fledgling synthetic fuels industry should be noted.

First, many of the companies who have been active in synthetic fuels face Section 3 problems. The Section 3 sanction may substantially reduce the already limited number of firms likely to participate in the permanent oil shale leasing program when it is reinstituted. Future leasing of tar sands may be similarly impacted. With fewer firms eligible to lease properties, there is not only less competition, but also a more restricted range of technological diversity and innovation which is essential in the early stages of a new industry's emergence.

Second, the lead times for coal-based synthetic fuels projects will extend beyond ten years under any realistic project schedule. Since new coal leases impose a ten-year commercial production deadline, few (if any) new coal leases can be used as a resource base for synthetic fuels projects. Pre-FCLAA leases (if Section 3 is repealed), with diligence periods extending beyond ten years (depending upon their scheduled readjustment date) offer the only federal coal which might be utilized for synthetic fuels. In fact, some of these pre-FCLAA leases were acquired for synfuel projects because of that increased timeframe, and contain coal not suitable for steam coal or metallurgical use. Without Section 3 repeal or modification, the only pre-FCLAA leases which could be usefully dedicated to synthetic fuels would have to be held by companies willing to accept the Section 3 sanction. Given the present short-term outlook for synthetic fuels, such action is highly unlikely.

CONCLUSION

As indicated, API is concerned with the problems created by the inflexibility of the Federal Coal Leasing Amendments Act of 1976. But no issue is more important than an early resolution of the special problem created by Section 3 in linking oil and gas leases to coal leases. This link needs to be broken immediately because absent legislative relief oil and gas producers are faced with the need to take irrevocable actions to dispose of their coal leases. The Section 3 sanction will not only remove coal reserves from a class of companies which has proven its commitment to coal development and production by its actions over the past ten years, but also likely will be a substantial obstacle to their future participation in Federal coal sales.

Because of the overriding concern which API members have expressed in breaking this link, API can support those bills now before the Committee (S.372, S.570 and S.913) which either repeal Section 3 or provide holders of non-complying leases greater flexibility in satisfying the Section 3 obligation. Because prompt action is paramount, the Committee may wish to give special consideration to S.913 which limits the Section 3 sanction to federal coal leases only (a feature of S.372 as well). Such action would break the oil and gas link with coal leasing. API also recognizes that comprehensive changes other than those contained in the three bills can provide flexibility needed by holders of non-complying leases to mitigate the Section 3 sanction.

Amendments addressing the leasing of federal coal by railroads have been proposed to S.570 by Sen. McClure. API has no position on this issue.

Also, before the Committee is S.946 which would bar the Secretary from issuing a new competitive coal lease to any corporation that produces coal in a foreign country and imports the coal into the United States. This ban would extend corporations affiliated with foreign producers whose coal is imported into this country. API opposes S.946 as unwise public policy. Such protectionist legislation is inconsistent with Section 1 of the Mineral Leasing Act which promotes reciprocity among nations and encourages international investment and commerce. Expanding the Section 3 sanction to foreign coal producers and importers also could trigger foreign retaliation against sizeable U.S. coal exports to the detriment of the domestic coal industry. Such protection while benefiting some U.S. producers, is likely to raise the overall cost of energy to consumers and U.S. industry. Finally S.946 would expand the scope of Section 3 to add a new class of entities who would be unable to compete for future federal coal leases. The sanctions imposed by Section 3 should be reduced in severity, not expanded as S.946 would do.

The legislative history of FCLAA makes it clear that its purpose was to bring federal coal leases into production and to prevent them from being held indefinitely for speculation. Section 7(a) promotes both objectives by requiring that coal leases achieve production in commercial quantities by the end of their tenth year or be terminated. For post-FCLAA leases, the ten-year period begins upon lease issuance; under DOI rulings upheld by the Interior Board of Land Appeals, the ten-year period for pre-FCLAA leases begins upon the first lease readjustment following the August 4, 1976 enactment of FCLAA. As DOI recognized in 1975/1976 in commenting on the draft legislation which became FCLAA, Section 3 sanctions were unnecessary and inappropriate. Section 7 - and not Section 3 - is FCLAA's diligence provision.

○